

Managing through persistent volatility: the evolving role of the CRO and the need for organizational agility

13th annual EY/IIF global bank risk management survey

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. Above the 'Y' is a yellow chevron shape pointing to the right.

Building a better working world



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Executive summary

The ongoing proliferation and continuous evolution of risks in the banking industry – highly volatile, intricately linked and emerging from seemingly everywhere – have made today's market and operational realities uniquely challenging for chief risk officers (CROs). At the same time, CROs are expected to command finite resources wisely and support transformation efforts designed to unleash innovation and satisfy rapidly evolving customer expectations.

The results of the 13th annual EY/Institute of International Finance (IIF) global bank risk management survey of CROs highlight the wide range of risks CROs must think about and prepare for. While many familiar risks remain at the top of CRO agendas, the threats are constantly changing and assuming new forms. Cybersecurity, which remains the top-priority risk for CROs over the next 12 months, is a perennial moving target in that attacks grow continuously more sophisticated and originate from new vectors. Similarly, concerns about financial risks have been amplified relative to prior years.

Geopolitical trade tensions may lead to increased counterparty credit risk for institutions with operations in impacted regions. Geopolitics could also test operational resilience if banks are forced to exit certain markets. Concerns about meeting regulatory rules and supervisory expectations, tied with operational resilience as the second-most urgent risk for the coming year, are embedded within multiple other risks.

As exceptional and daunting as current conditions may seem, the level of uncertainty they have produced is very likely to persist, which means a higher regulatory bar seems certain. Thus, banks must continue to build the necessary capabilities and infrastructure – across all three lines of defense and in the business – for increased responsiveness in identifying, managing and reporting on risks.

Our survey results suggest it's time to align the risk management operating model, from the boardroom to the front lines, for today's volatile market and its constantly evolving risks. Specifically, the findings emphasize the need for:

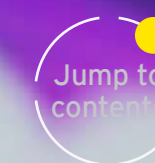
- ▶ **An emphasis on critical thinking skills:** hiring and training risk professionals who can see across traditional risk disciplines, synthesize insights from different data sets and offer detailed guidance without losing sight of the big picture

- ▶ **Increased organizational agility:** instilling flexibility through adaptive capabilities and processes, deploying talent and taking action to address shifts in risk priorities
- ▶ **Further adoption of advanced technology:** automating core processes (such as fraud monitoring, controls and reporting) to more quickly identify and track risks and free talent for higher-value tasks
- ▶ **Stronger data management and analytical capabilities:** promoting forward-looking risk visibility and enabling pattern recognition through predictive modeling, scenario planning and data visualization

In investing in these areas, the end goal should be an agile risk function able to accurately track and respond decisively to urgent threats today, while confidently devising plans for over-the-horizon risks.

For all the challenges, this year's findings indicate that many of the steps CROs and regulators have taken in the last several years have de-risked core aspects of the banking system. The improved frameworks established during the last decade can serve as a foundation for highly agile and technology-enabled capabilities.

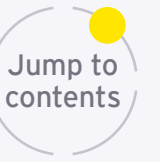
Finally, our results also reveal differences in the risk and transformation priorities across regions and different types and sizes of banks, as well as among global systemically important banks (G-SIBs) and non-G-SIBs. In some cases, the variances are quite pronounced, telling a tale of different market realities.



Recent history demonstrates why CROs need to scan ever broader horizons. Rampant uncertainty means unexpected impacts are to be expected and surprise developments can no longer be considered surprising.



Four key takeaways from this year's survey:



1

Fast-moving and ever-evolving external risks challenge CROs to determine where they reside and how they'll impact the business.

The last few years have proved conclusively that major risks can emerge overnight and from almost anywhere. Leaving aside black swans and the global pandemic, some banks have faced existential threats that originated in the macroeconomic environment and broader market and others



from sudden shifts in consumer behavior or from within their own day-to-day operations. Recent history demonstrates why CROs need to scan ever broader horizons. Rampant uncertainty means unexpected impacts are to be expected and surprise developments can no longer be considered surprising.

It's worth noting that outside the events of spring 2023, market volatility has not resulted in worst-case outcomes. But, as evidenced by the resurgence of financial and regulatory risk on their near-term priority list, CROs have learned to prepare for the worst, along with a broad range of scenarios.

Vigilance and prudence should also be applied to those risks thought to have migrated outside of the

regulated banking system, such as those associated with private credit and others on the balance sheets of non-banking financial institutions. Where and how traditional banks may be exposed to such risks can't be allowed to turn into a blind spot.

The many intersections among different risk types complicate the jobs of CROs today. Finding the points of connectivity between external risk drivers and firm-specific risks requires sophisticated scenario modeling. Determining appropriate actions necessitates clear and creative thinking on the part of CROs. Those who have confidence in their data and adopt advanced technologies, will be able to act preemptively against crystallizing risks.

2

The “forever” threats of cyber and climate function as risk portfolios, with residual risks unlikely ever to reach acceptable levels.

While CRO priorities can seem to shift from day to day, cyber and climate have become fixtures at the top of the agenda. They seem unlikely to reach the point of stability or manageability that banks would normally aim for.



CROs expect cyber to demand the greatest share of their time and attention in the immediate term – no surprise given the increasing sophistication of attacks, the massive volume of breach attempts and the relentlessness of bad actors. But our survey findings, along with our ongoing market engagement, suggest that this year’s cyber threats are much different than those of past years. Their specific manifestations and impacts change significantly year-over-year (YOY). New developments in generative AI and quantum computing could lead to an exponential increase in the potential severity of cyber risks.

Our historical survey results also show that climate risk has grown to prominence in a relatively short time. However, CROs recognize it’s here to stay and will only become more important in the future. And it’s comparable to cyber in terms of its far-reaching impact, complexity and continuous evolution.

Climate-related regulatory risk will be recalibrated regularly, based on fluid political situations and potential conflicts in standards across jurisdictions, geographies and industries.



Climate is unlike cyber in one critical way: sustainable finance and environmental, social and governance (ESG) provide opportunities for banks to generate revenue through “green” financing and other offerings, which may also help mitigate climate risks in the long term.

In defining frameworks for both cyber and climate risk, CROs can monitor the evolution of many different dimensions and sub-risks (e.g., assessing third-party vulnerabilities and data privacy threats related to deploying artificial intelligence (AI); and balancing transition and physical risks in climate risk strategies).

37%
points:
the gap between
cyber and the
next risk on CRO
priority lists for the
next 12 months



3

From firewatcher and fortune teller, to tech and data guru, to change agent and culture shaper, CROs are playing more roles than ever.

In the past, CROs were likely to be experts in credit, market and operational risk. Today, beyond that core expertise, CROs must display extreme versatility. Consider the many different - and sometimes contradictory - elements of their job descriptions:

- ▶ Cultivating deep technical knowledge (e.g., on regulatory matters) and maintaining strategic expertise about the business (and ensuring their teams do, too)
- ▶ Understanding a broader range of risks and their underlying causes (e.g., geopolitics, monetary policy, labor market dynamics and partner relationship management) and being able to think creatively and counterintuitively about their potential impacts
- ▶ Focusing on immediate-term threats and looking into the future
- ▶ Solving for scarce talent and harnessing advanced technologies to boost functional performance
- ▶ Building robust controls without becoming a barrier to product innovation or increased customer engagement

Any leader asked to both run and change the business must constantly balance near-term pressures with long-term objectives. For CROs, that means providing constant protection for business-as-usual operations while simultaneously facilitating transformative change and growth-oriented innovation. It's a lot to ask. CROs increasingly recognize the power of a stronger risk culture in helping them deliver on their varying mandates.

Given proliferating risks, it's worth asking just how many CROs a bank might need today and where they might be deployed most effectively across the organization (e.g., in divisions and regions or by risk type). The survey results show that the answer for the majority of banks is multiple CROs. Figuring out roles and responsibilities and ways to promote collaboration are important questions for the future.



67%

CROs who say they expect their role to evolve to include serving as a "watchtower" for triangulating and advising the board and senior management on intersecting risks



4

The immediate-term talent crisis has largely abated but attracting and retaining Gen Z workers and those with the most in-demand skills are significant long-term concerns.

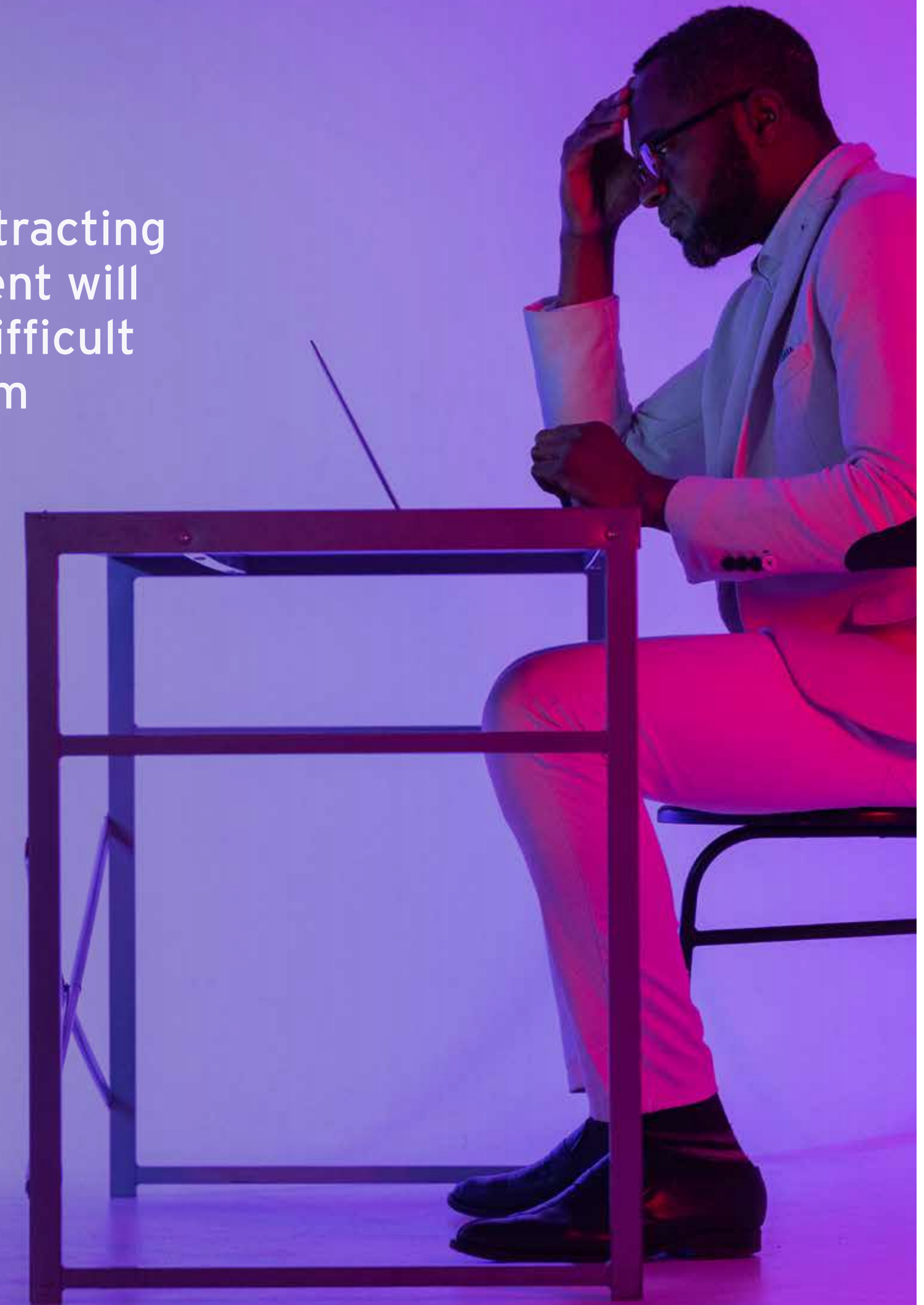
Though the “War for Talent” and “Great Resignation” have faded from the headlines, nearly every bank still needs more skilled people, both in the business and risk management. Cyber and data science expertise remain priorities for CROs, who want to enhance skill levels in both the first and second lines of defense.

There is also a premium on so-called softer skills, like critical thinking, which is necessary to identify connections between risks and to envision where the next big threat will come from. Stronger leadership and communications skills can help CROs guide their organizations by charting a safer and profitable course through a very uncertain landscape.

Reskilling will be necessary to resolve persistent shortages of specific talent and the difficulties in retaining key staff, as will alternative sourcing strategies. Looking forward, CROs would do well to engage with human resource (HR) leaders to ensure that risk management careers provide sufficient rewards and development opportunities to attract current and future workers. With Gen Z - roughly those born between the mid-1990s to the early 2010s - becoming a larger presence in the workforce, these questions will need to be answered.

66%

CROs who say attracting and retaining talent will be increasingly difficult over the long term

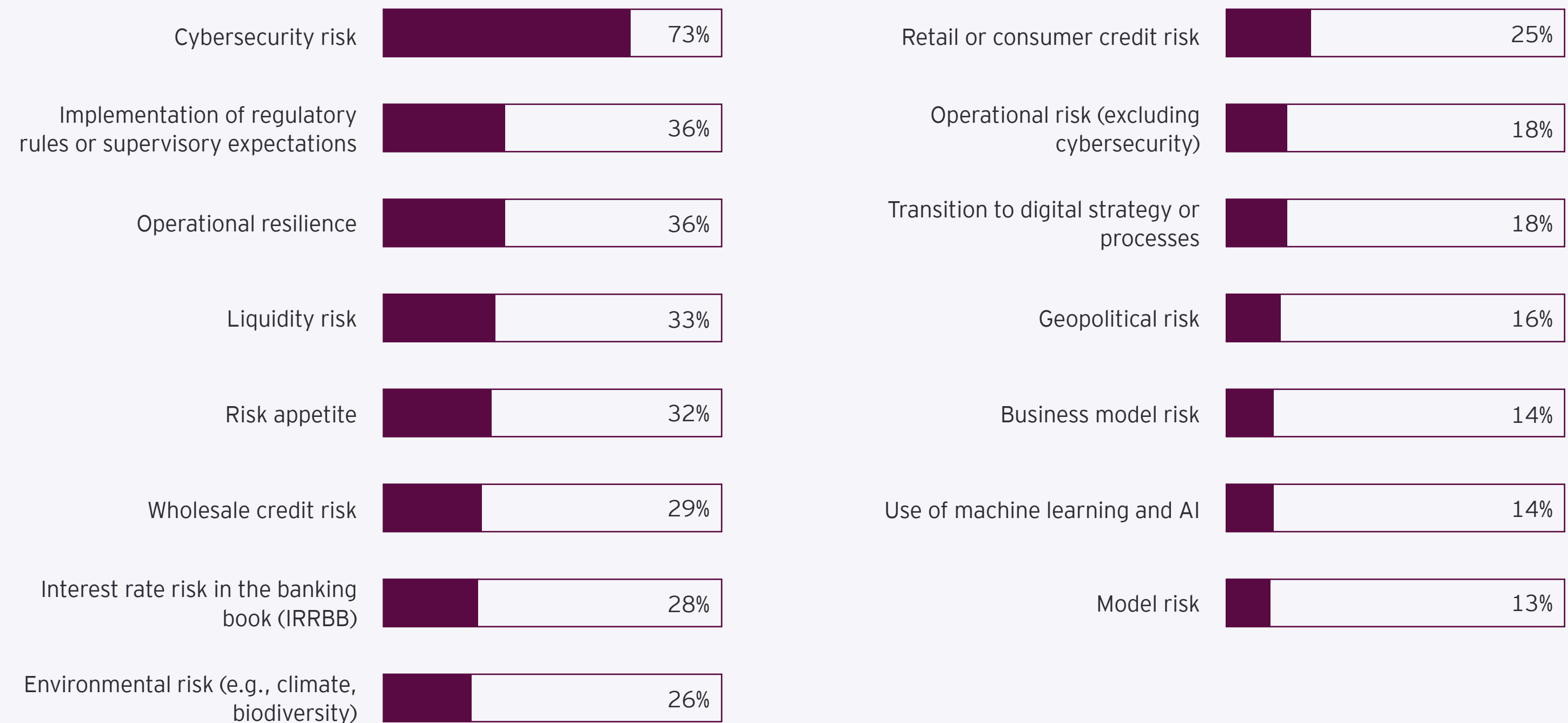


Chapter 1

Pervasive and ever-changing threats: the reality of risk management today

The top risks in our annual survey reflect the durability and prevalence of a few perennial threats, while also suggesting the diverse nature of banks' risk profiles today. Cybersecurity risks continue to dominate, while regulatory, financial and operational risks are never far from CROs' minds.

Figure 1: Over the next 12 months, what are the top five risk management issues that will require the most attention from the CRO?



Financial risks are resurgent. After several years where our survey results showed CRO confidence that these traditional risks were manageable, the events of spring 2023, higher interest rates and overall macroeconomic uncertainty have moved them back up the risk management agenda. For more on financial risk see page 12.

In last year's survey results, credit risk was cited as a top-five near-term concern by 59% of CROs, making it the second-highest near-term risk priority. In this year's survey, respondents showed a similar level of overall

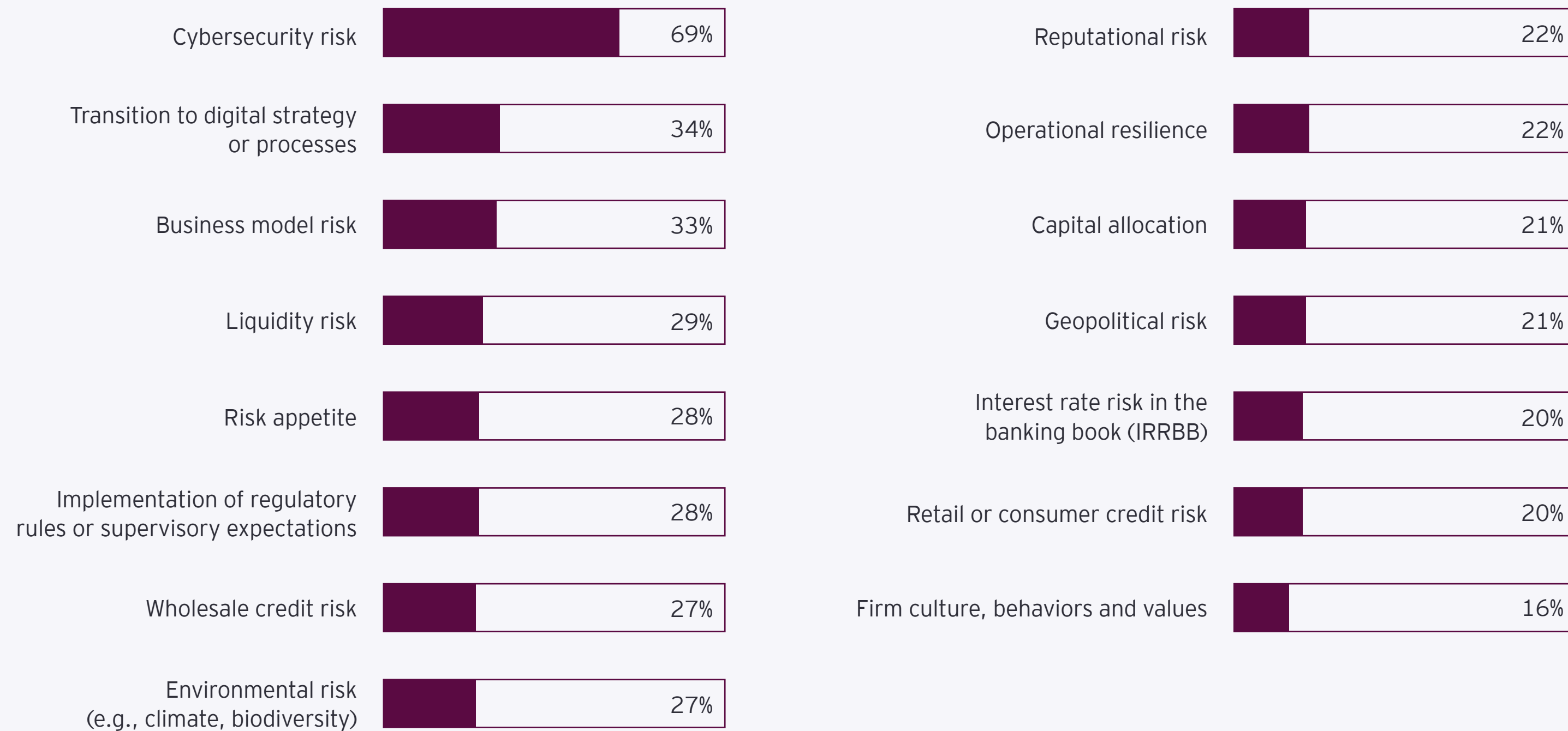
concern in more specific questions about wholesale risk (29%) and retail or consumer risk (25%). More than twice as many CROs said liquidity risk would be a top-five issue in 2024 (33%) than did for 2023 (16%). CROs at smaller and mid-sized banks drove the spike in concern about liquidity risk.

Geopolitical risks fell from 28% last year to 16% this year. However, it's worth noting that the 2023 conflicts in the Middle East began after our survey closed. For more on geopolitical risk see [page 11](#).

Alignment between CROs and boards

CROs believe their priorities largely align to those of their boards, both for the next 12 months and the next five years. That's especially true relative to financial risks. The largest variation relates to digital strategies, which CROs expect boards to prioritize to a much greater extent. CROs believe they will focus more on regulatory and supervisory concerns than will their boards.

Figure 2: Over the next 12 months, what are the top five risk management issues that will require the most attention from the board of directors?



The outlook for emerging risks

Climate change and AI are the risk priorities that CROs expect to increase the most in importance during the next five years. They expect it to top the list of board concerns. See figures 3 and 4. The alignment of CRO and board concerns is particularly notable this year. That global regulatory fragmentation is just outside the top 10 suggests that CROs expect regulatory pressures to recede at least somewhat or that they will have grown accustomed to them in the next five years.

Last year, climate risk was cited by 65% of CROs; this year's drop to 56% suggests that CROs are growing familiar with more of the many moving parts of climate risk, including near-term reporting imperatives. On the whole, our survey results show both that CROs recognize the need for more understanding and action relative to climate risk, and increased efforts to close those gaps. For more on climate risk see page 13.

AI and machine learning risks have gained prominence as emerging risks in the eyes of CROs since last year's survey, with usage risk almost tripling (from 13% to 38%) and model risk more than doubling (from 18% to 38%). The implication is that more widespread deployments will make AI a more tangible day-to-day risk by 2029.

Data and technology concerns remain high on the list of longer-term priorities, reflecting the relentless digitization of all aspects of the banking business. While cyber risk is not listed as an answer to this particular survey question, it's an underlying factor in several of the most common choices.

Figure 3: What emerging risks do you believe will be most important for your risk organization over the next five years?

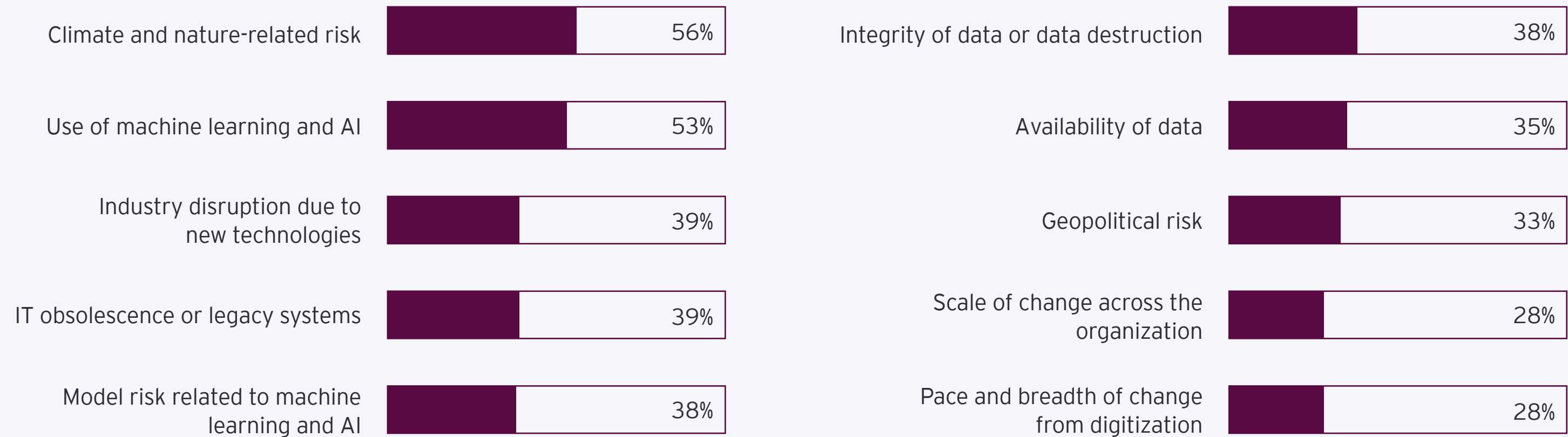
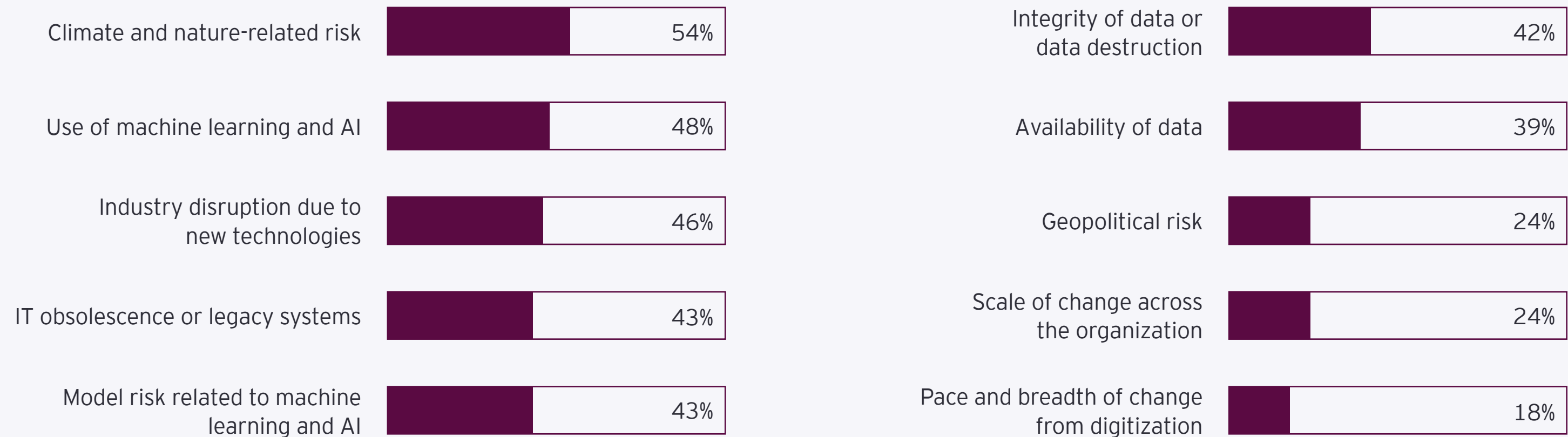


Figure 4: In your opinion, which would be the most important to the board of directors or risk committee of the board over the next five years?





In focus: geopolitical, financial, climate and regulatory risks

The growing urgency and complexity of climate and geopolitical risk have been reflected in our survey results during the last several years. The return of financial risks and prominence of regulatory concerns are less a “back-to-basics” reorientation of CRO priorities than a sign of the times. Indeed, to some extent, our survey results can be read as an index of major world events during the last 12 months and as evidence of the speed with which headline news is manifested on the CRO agenda.

The uncertain world of geopolitical risks:

CROs have long paid attention to the statements and policies of central banks around the world. Only recently, for the first time in many decades, have they had more reason to become experts on international relations. Though geopolitical risk fell as a CRO concern in this year’s survey, we expect it to remain a prominent focus area. CROs must stay attuned to more aspects of global affairs because of the range of negative outcomes and impacts from existing regional conflicts, the emergence of new tensions on the world stage, and other forms of political turmoil.

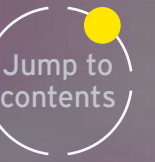
The war in Ukraine triggered the return of geopolitical risk to CROs’ priorities in last year’s study. This year’s findings make clear that the international stability that banks grew accustomed to through the 1990s may be out of reach for the foreseeable future. Sanctions, cyber impacts and operational resilience implications are important dimensions of geopolitical risks. A full 83% of CROs say geopolitical risks will have a somewhat more significant effect (35%) or the same effect (48%) in five years than they do today.

Increasing cyber attacks are the most likely manifestation of geopolitical risk, according to 69% of CROs. Similar proportions expect a global economic downturn (67%, including 91% of CROs from the Asia-Pacific region) and increased market volatility (65%) to have the greatest effect on their organization relative to geopolitical risk.

Our results indicate a clear trend: the larger the bank, the more likely the CRO prioritizes geopolitical risks. Of CROs at banks with \$1t of assets, 71% say it is important to their organization in the next 12 months (versus 33% of all CROs) and 100% say it is important to their boards (versus 48% overall). 57% say the impact will be more significant versus 35% overall. G-SIBs are considerably more focused on geopolitical risk as an emerging risk than non-G-SIBs.

83%

CROs who say geopolitical risks will have a greater or the same impact in five years as they do today



The resurgence of financial risk:

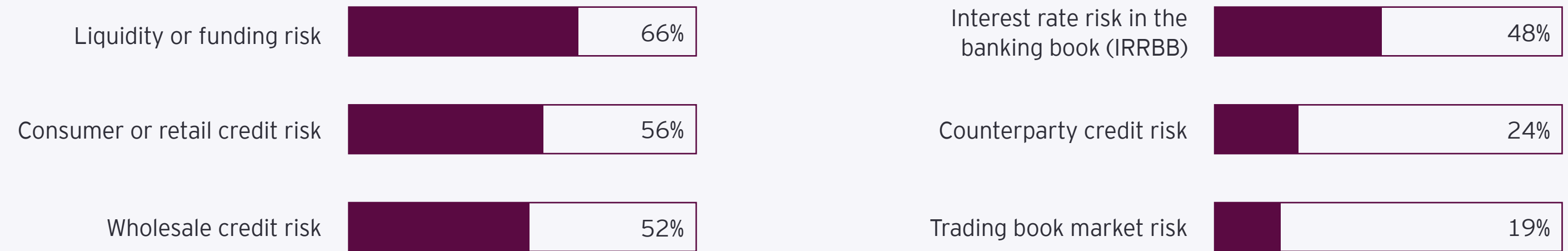
Despite a relatively soft landing for mature economies coming out of the pandemic, financial risks are front and center for many banks. The events of spring 2023 no doubt exacerbated the sense of foreboding from general macroeconomic uncertainty. With banking a largely digital business, the very notion of a run on a bank has changed; it won't be marked by lines of depositors extending around street corners, but rather by many users simultaneously tapping mobile apps to withdraw funds.

Again, overlap in risk stripes could amplify the impacts of new financial policies or a broader economic downturn. CROs must track a wide range of trends, from performance of the housing market in Asia, to the psychology of US consumers, to European jobless rates, to currency markets in Latin America.

Interest rate risk in the banking book (IRRBB) and liquidity risk saw significant jumps from last year's results. See figure 5. All banks (100%) with >US\$1t of assets cited liquidity or funding risks as priorities this year. Commercial real estate (CRE) is the most likely area of a portfolios to be impacted (no surprise there), with residential real estate a particular concern for banks in the Asia-Pacific region (75% versus 32% overall) and leveraged lending a big concern for G-SIBs (80% versus 48%).



Figure 5: What are the top financial risks that concern your organization over the next 12 months?

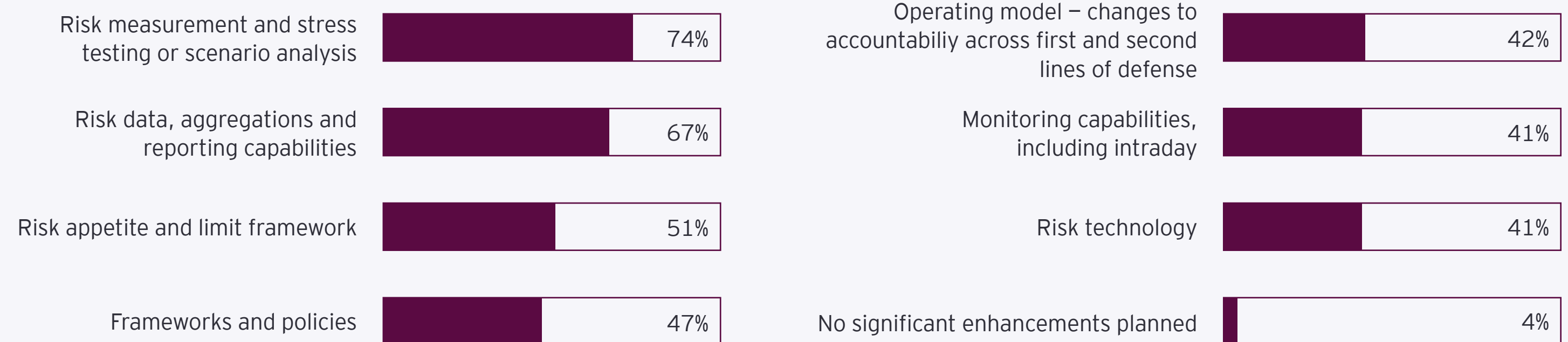


Banks are taking a range of actions (e.g., new measurements, stress testing and scenario modeling) targeted to financial risk management. For instance, in response to credit risk concerns, which include CRE (71%), non-real-estate consumer credit (49%) and leveraged lending (48%), banks are tightening lending standards (86%) and curtailing lending to high-risk industries (75%).

Risk measurement, stress testing and scenario modeling are how CROs plan to enhance financial risk management capabilities over the next 12 months,

followed by risk data aggregation and reporting. See figure 6. Banks are focused on a few key steps to mitigate credit risk and liquidity risk, with G-SIBs particularly focused on crisis management plans. A full 70% of G-SIBs plan on making key enhancements to frameworks and policies in the next 12 months, compared to 47% for non-G-SIBs.

Figure 6: What key enhancements is your bank planning to make to its financial risk management capabilities over the next 12 months?



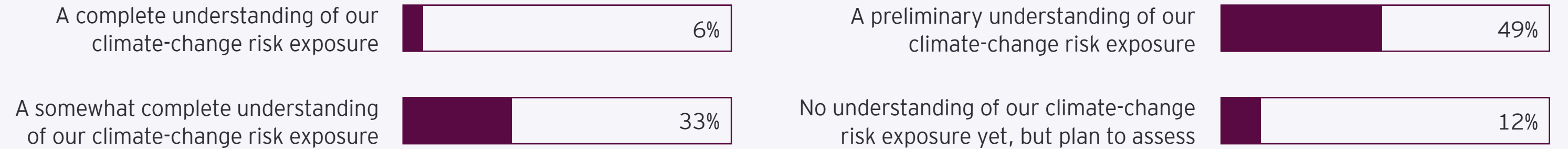


Climate risk in a time of change:

In just a few years, climate risk has forced itself near the top of the list of CRO priorities. Given the nature of the problem, we expect it to remain there for many years to come. Our results show that climate risk is still viewed as more of a future risk, though it remains on the list of top 10 priorities for the next 12 months for both CROs and boards. The regulatory and political dimensions of climate change only add to the vast complexity of this risk category.

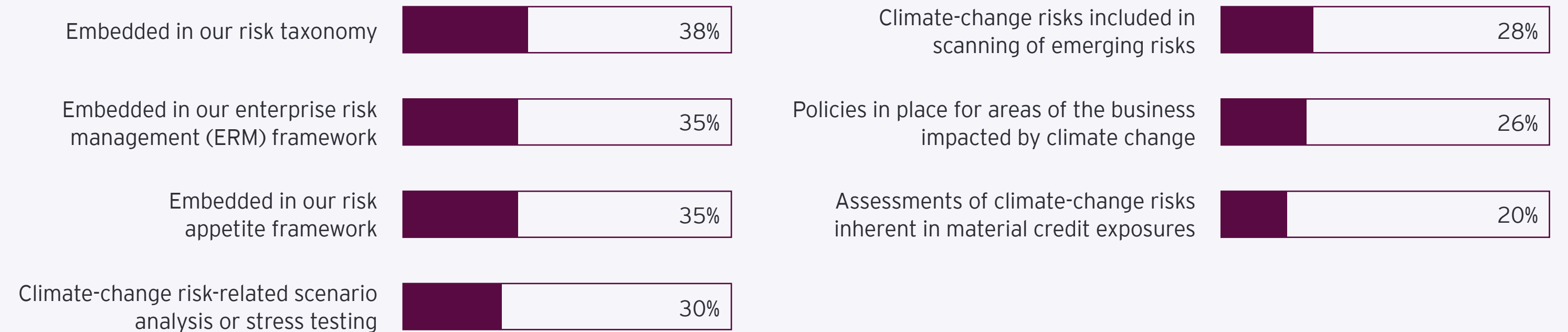
Our results show how CROs and banks have begun to break down climate risk. First and foremost, they are coming to terms with what they know and don't know. A large majority of CROs recognize gaps in understanding both physical and transition risks related to climate change; very few report a complete understanding. See figure 7. Nearly half of survey respondents (49%) say they are still building out their second-line climate risk teams while less than a third (30%) are assessing whether they need one.

Figure 7: How would you characterize the maturity of your understanding of exposure to both climate-change physical risks and transition risks?



CROs say they are acting to incorporate climate risks into risk management activities, particularly in relation to taxonomies and frameworks. See figure 8. There's every reason to believe these holistic efforts will become commonplace at more banks in the future, particularly relative to tangible steps, such as policy development and formal assessments of material credit risk exposure. Successfully navigating climate risk in the future will require both deep, broad-based expertise and bold, creative action. As such, it's a microcosm of the CRO role today.

Figure 8: Which of the following are the most important ways that climate-change risks are incorporated into your firm's risk management activities?



Rising regulatory concerns:

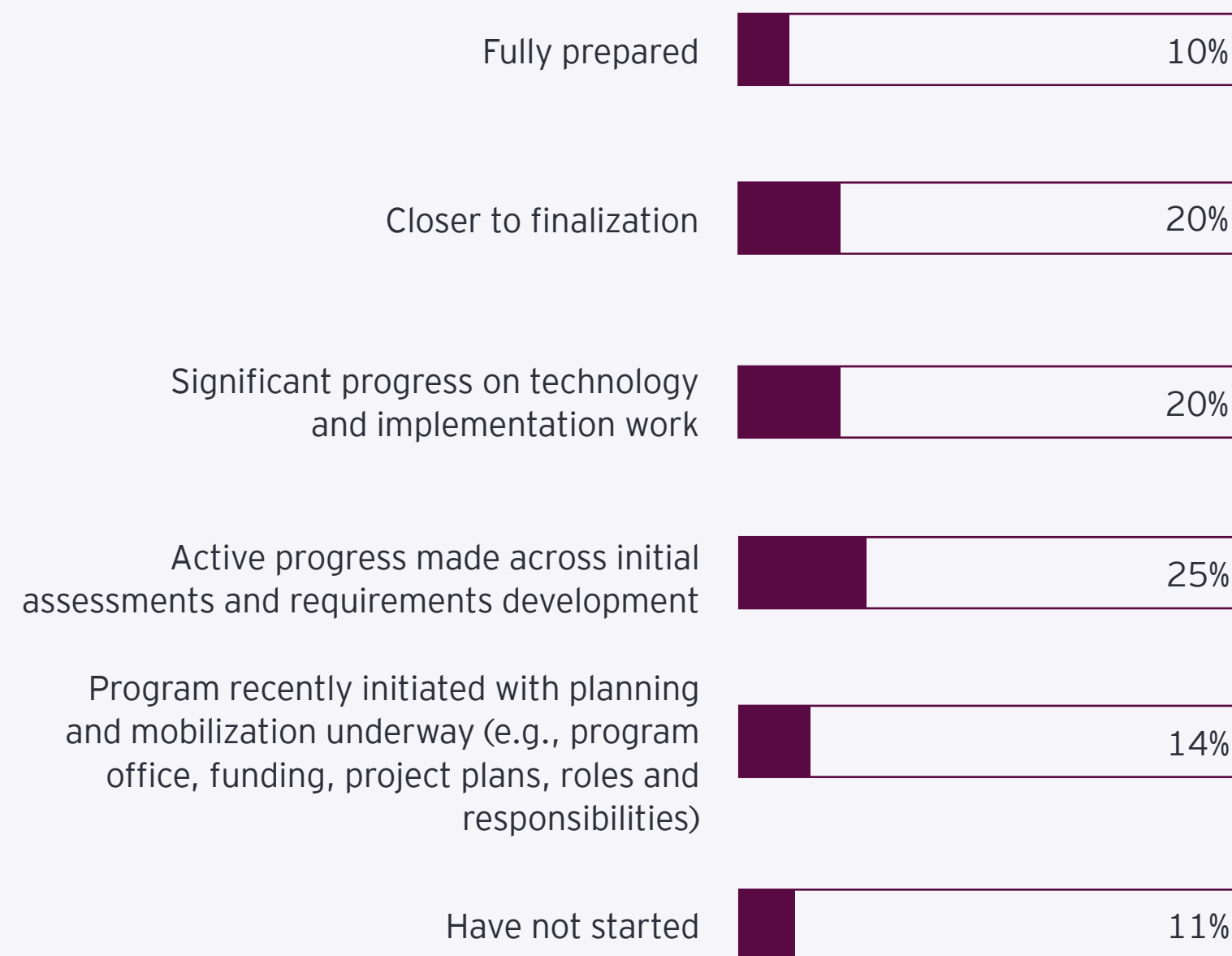
In our 2015 and 2016 surveys, regulatory risk was the top CRO priority. In 2020 and 2021, it had fallen to the sixth position. This year, CROs named it their second most important priority for the next 12 months.

Much of the rise came from banks with US\$500b to US\$1t in assets; 50% of CROs from this group cited the implementation of regulatory rules and supervisory expectations as a top near-term priority, versus 36% overall. North American CROs reported the highest level of concern (45%) and Latin American CROs the lowest (25%). G-SIB CROs (30%) were somewhat less focused on regulatory and supervisory matters than their non-G-SIB counterparts (37%).

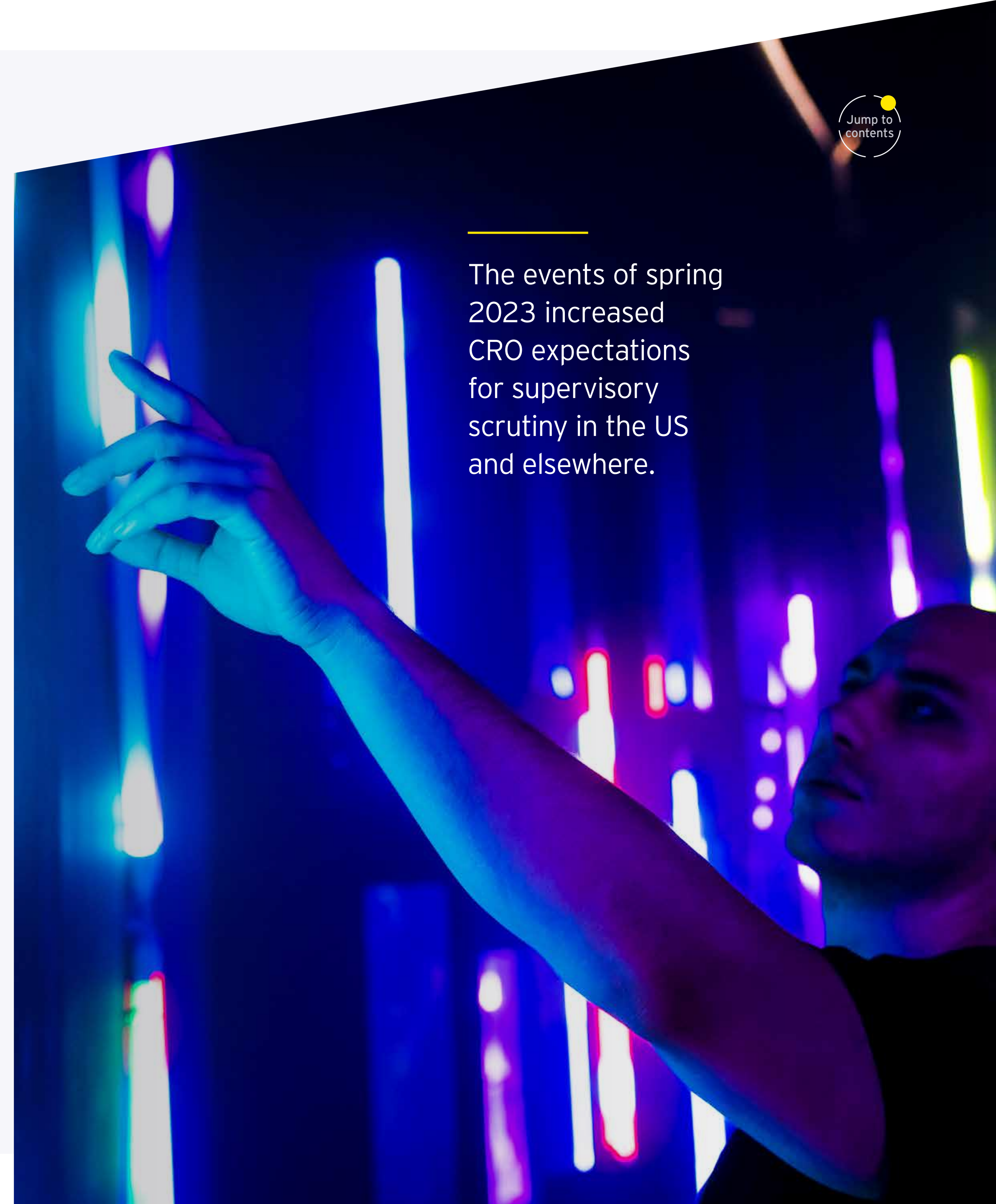
A number of factors prompted the rise of regulatory concerns. The events of spring 2023 increased CRO expectations for supervisory scrutiny in the US and elsewhere. Existing regulatory priorities, such as climate-related requirements, likely also played a role; banks may need to adopt a more holistic approach to ESG to avoid the prospect of “greenwashing” accusations.

Readiness for Basel III finalization may also have been a factor. Half of banks are in the early stages of preparation. See figure 9. Only 10% of CROs report that their institutions are fully prepared, while 11% have not yet kicked off their implementation efforts.

Figure 9: What is your organization’s readiness with respect to Basel III finalization?



The events of spring 2023 increased CRO expectations for supervisory scrutiny in the US and elsewhere.



Chapter 2

The transformation agenda: how risk can align to the business

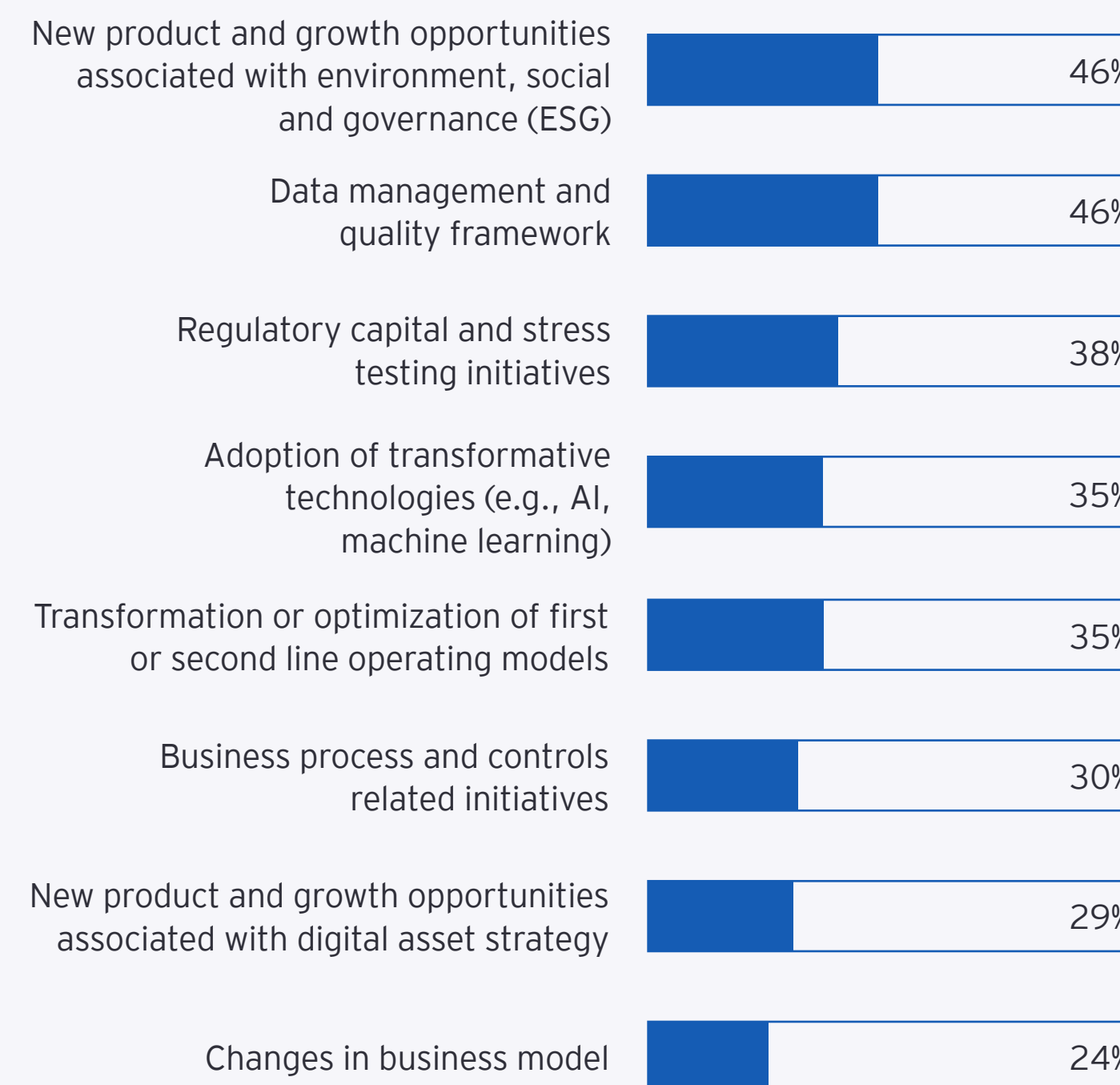
As the business drives continuous change in pursuit of performance improvements, risk leaders must strive to engage both strategically and tactically — even as they seek to optimize their own functions. Banks continue to embrace widespread transformation programs to meet shifting customer needs, stay ahead of new competitors and achieve operational excellence.

Our survey indicates that CROs are involved in many – but certainly not all – of these programs. See figure 10.

Nearly half, or 46%, of CROs are engaged with new product and growth opportunities related to ESG, with wide differences by region. For instance, only 18% of North American CROs are involved in these initiatives, compared to 82% of their peers in the Asia-Pacific region and 75% in the Middle East and North Africa.

CROs are less involved in the adoption of transformative technology, according to our survey. That only 35% of CROs are involved as stakeholders in such initiatives may be a missed opportunity to advise the business. It may also lead to heightened technology risk in the future. Relative to establishing effective oversight of emerging technologies, lack of talent is the biggest risk (cited by 61% of CROs), followed by available data to support independent aggregate oversight (54%) and technology to enable ongoing risk management activities (54%).

Figure 10: What are the major enterprise-wide change initiatives that involve risk as a key stakeholder group?



Top constraints to accelerating digital transformation

54%

Scale of change required

48%

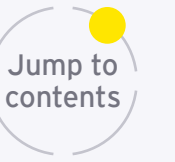
Limited budgets

26%

Challenges on prior technology transformations

25%

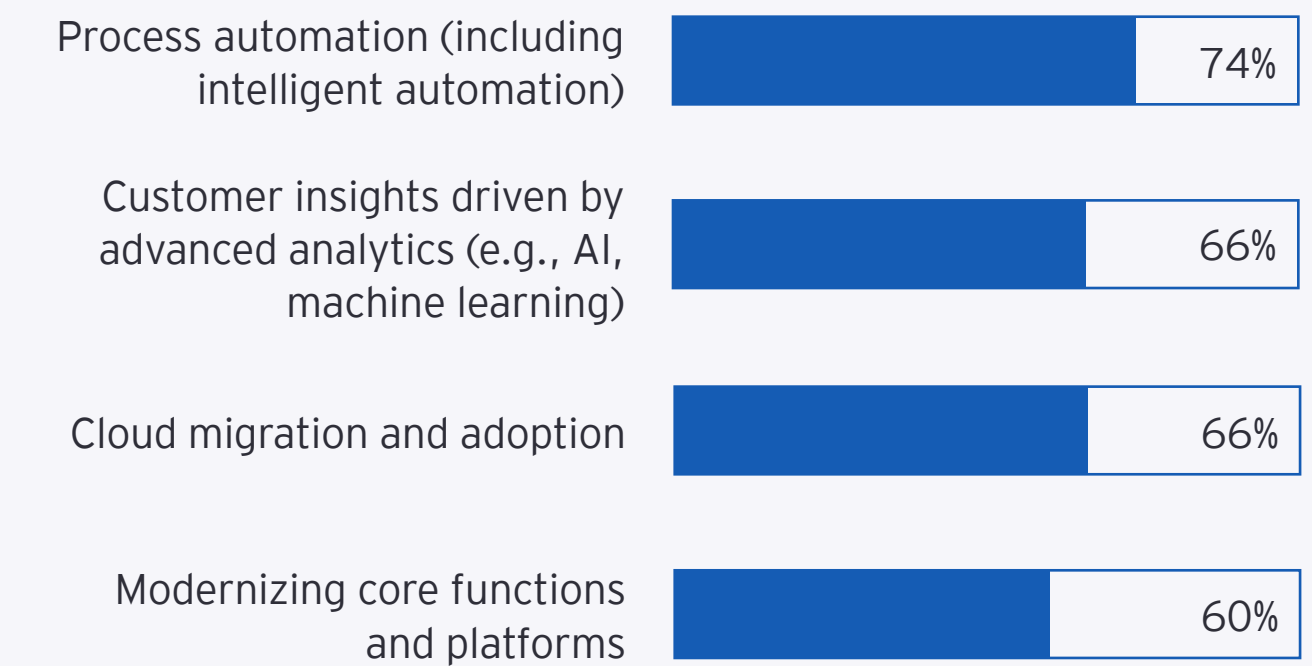
Lack of sustained commitment to challenging priorities



Digital transformation efforts will accelerate on multiple fronts during the next five years, meaning CROs need to stay aligned and engaged with business leaders, including process automation (named by 74% of CROs), customer insights (66%) and cloud migration (66%). See figure 11. Asia-Pacific CROs (82%) and those in North America (75%) are the most focused on driving customer insights, while European CROs prioritize cloud migration (82%). That only 29% of CROs from the largest banks and 40% from G-SIBs, compared to 60% of overall respondents, are focused on modernization suggests that these institutions have already modernized much of their core.

CROs from all regions and sizes of banks identified the scale of change (54%) and limited budgets (48%) as the biggest constraints to accelerating transformation. At the largest banks, the scale of change (cited by 86% of CROs) and lack of commitment to challenging priorities (57%) are notably bigger issues. CROs at G-SIBs are considerably more likely to say budget is a constraint (80% versus 48% overall). CROs at North American banks feel most challenged by the scale of change required (72%) and budget (62%).

Figure 11: What are the top ways your bank will accelerate digital transformation in the next five years?

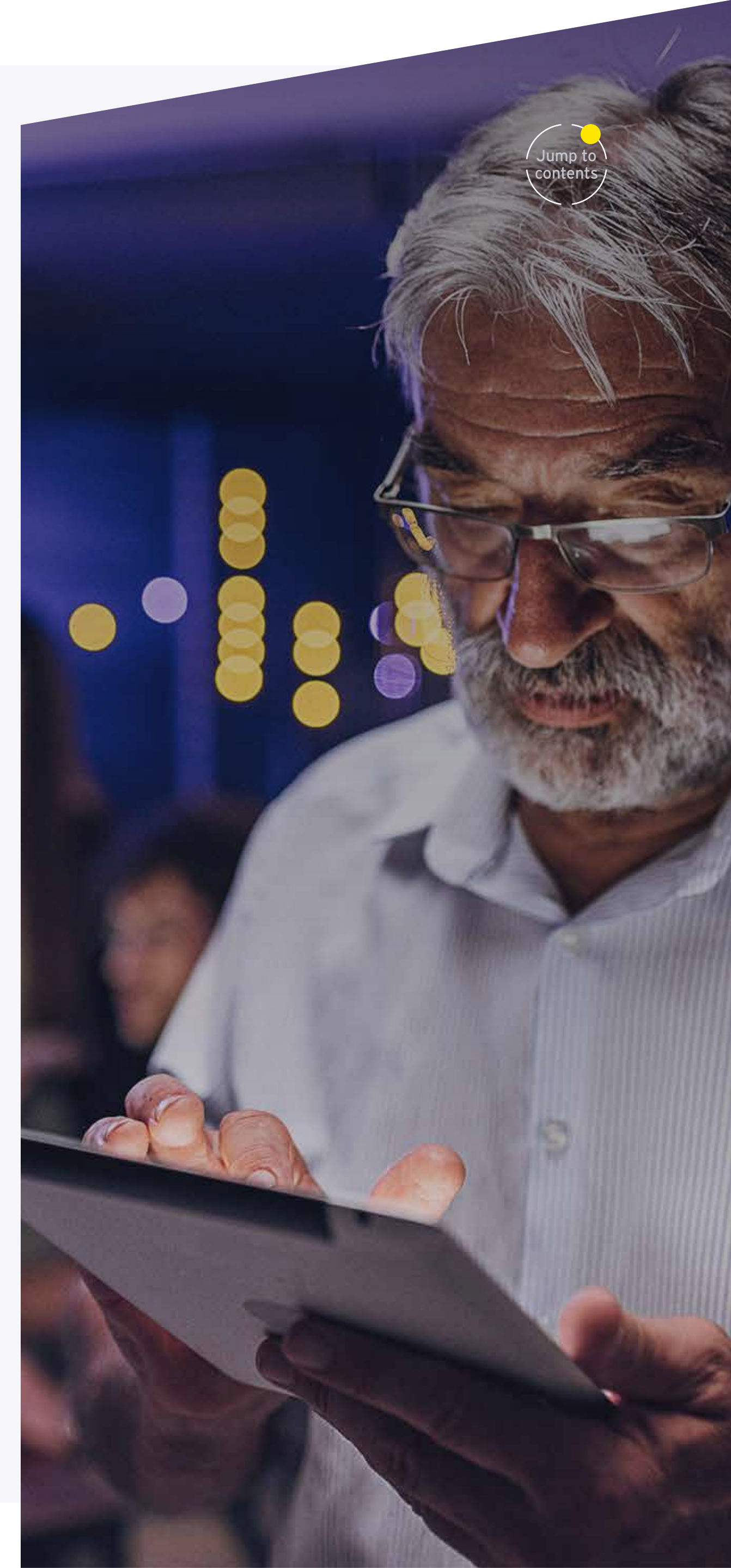


Focusing on data management

CROs recognize data's prominence and broad-based impacts. See figure 12. Regulatory requirements and supervisory expectations (cited by 52% of CROs) top the list of factors influencing data management priorities. But CROs see the importance of safe and effective data management practices to providing more insights to customers (45%), successfully executing business growth initiatives (36%) and increasing customer understanding. Only 8% of Latin American CROs see regulatory and supervisory expectations as a top influence, compared with 71% of their counterparts in Europe. These results are evidence of CROs' understanding the need to balance their functional responsibilities (safeguarding the company's assets and reputation) with broader business objectives.

In terms of the data-usage risks requiring their attention in the next 12 months, 49% of CROs cited data quality, accuracy and completeness as the top issue. European CROs are especially focused on data quality (65%). Cyber was a distant second at 27%, followed by regulatory compliance at 14%.

Figure 12: Over the next year, what are the top factors influencing your bank's data management priorities?

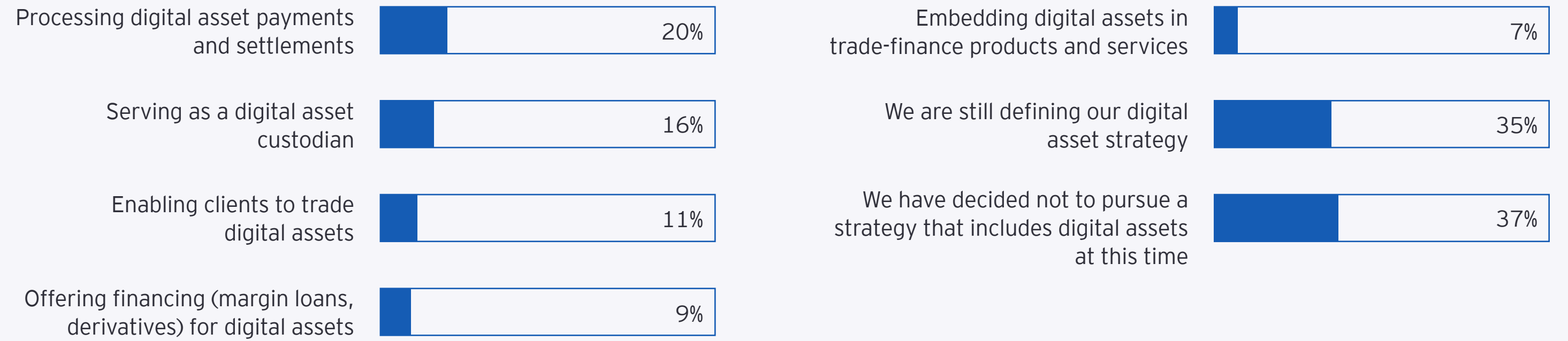




Digital asset strategies under development

Most banks are still defining how to interact with digital assets and how they may be most useful to the business. That means CROs are also figuring out how to manage the associated risks. In this year's survey, 37% of respondents said their banks are not pursuing a digital asset strategy, while 35% are still defining their digital asset strategies, down from 49% last year. See figure 13. The implication is that a significant number of firms are moving forward with digital assets, but more than a few have paused or are rethinking their approach.

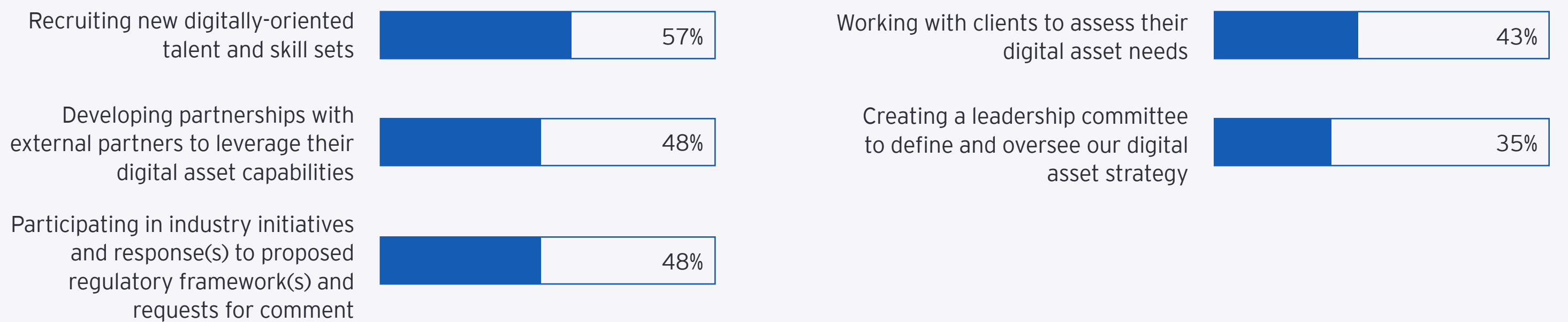
Figure 13: What elements of a digital asset strategy is your bank pursuing?



Digital assets strategies have expanded far beyond crypto and alternative currencies. Tokenization has emerged as a potential area for innovation, with more banks exploring and piloting potential use cases. In terms of key elements of digital asset strategies, payments processing (cited by 20% of CROs this year, up from 14%) and custodianship (11% to 16%) both saw upticks since our last survey. Banks in the Asia-Pacific region are most likely to adopt strategies that enable clients to trade (27% versus 11% overall).

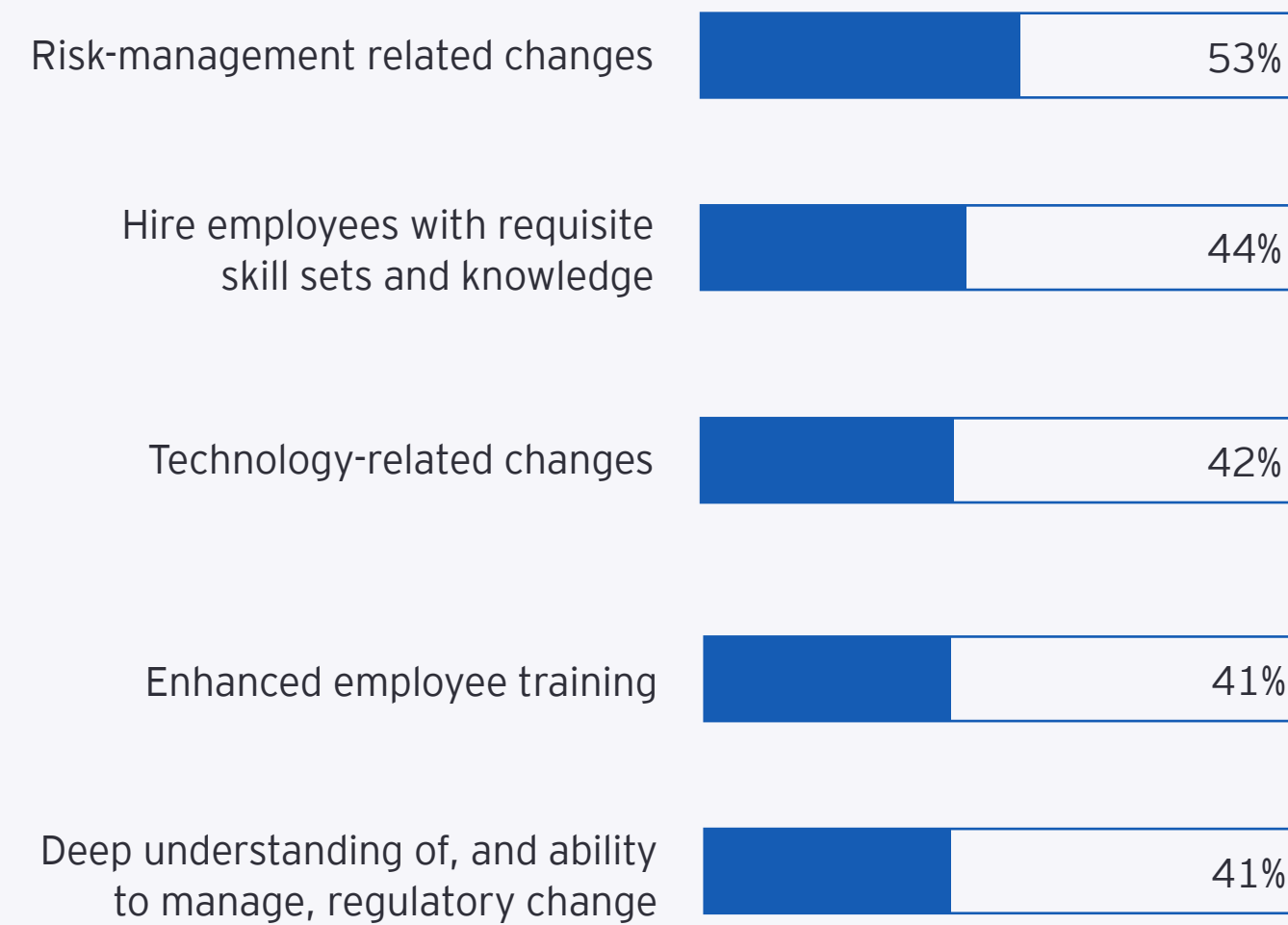
While it's still early days for digital assets, talent and hiring are focal points for risk management strategies for digital assets. See figure 14. More than half of firms are prioritizing recruiting, and nearly half are working on partnerships and industry and regulatory interaction to inform their digital asset strategies, in parallel to working with clients. Larger banks are more aggressive in pursuing digital asset strategies and view hiring as key to execution. European banks pursuing digital assets are most focused on securing the necessary talent (80% versus 57%).

Figure 14: How is your bank informing its digital asset strategy?



Even as many banks refine their digital asset strategies, CROs appear to be preparing to manage the related risks. More than half (53%) believe risk management changes will be needed for digital assets. A full 82% of Asia-Pacific CROs say changes are needed. See figure 15. Again, talent is a focal point, with 44% believing hiring will be required. Larger banks see the greatest need for hiring, perhaps because they are more likely to be farther along on their digital asset journey.

Figure 15: What changes will your bank need to make to manage risks associated with your digital asset strategy?



Larger banks see the greatest need for hiring, perhaps because they are more likely to be farther along on their digital asset journey.



Where ecosystems and alliances stand

Banks continue to pursue ecosystem and alliance strategies, though our results suggest something of a slowdown. Adoption of business ecosystems is a priority for larger banking institutions, driven mostly by the need for cost efficiency and new customer acquisition. See figures 16 and 17. Latin American banks are more focused on ecosystems than institutions in other regions.

Figure 16: To what extent has your bank outlined an ecosystem or alliance strategy?

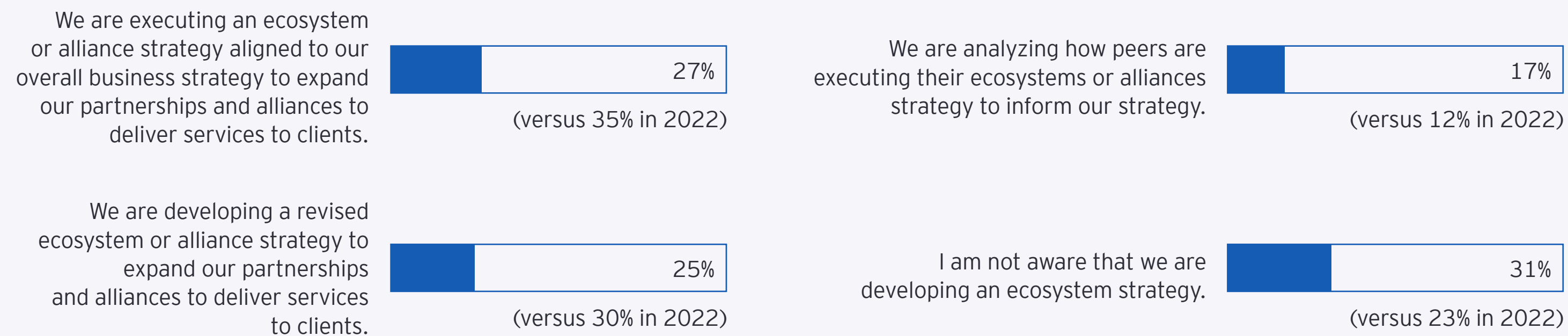
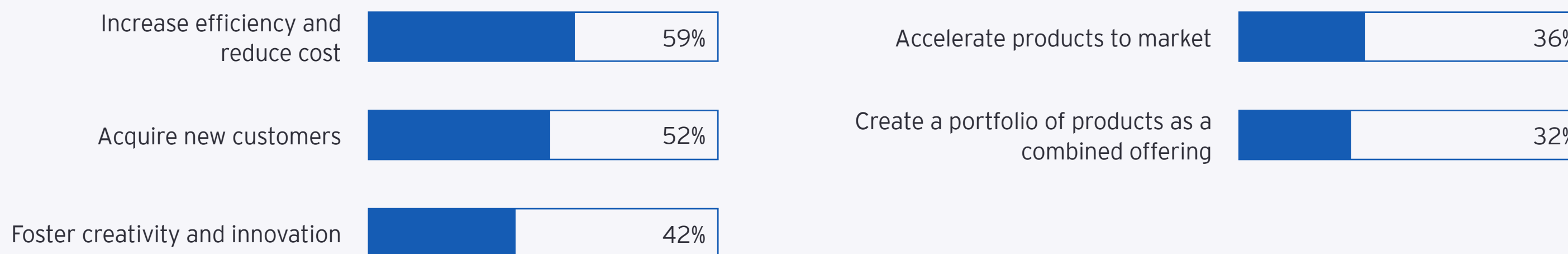


Figure 17: What are the top drivers behind your ecosystem or alliance strategy?



However mature their banks' strategies, CROs see cyber (67%) as the top ecosystem-related risk, followed by data privacy (43%) and third-party (39%) risks. Here again, cyber risks are inherent in banks' main growth strategies.

Green risks and opportunities – climate, sustainable finance and ESG

Our research shows that banks are showing progress in addressing sustainable finance risks and opportunities. However, clearer alignment to overall business strategy is necessary, according to CROs, and gaps remain in understanding climate risk.

Banks perceive significant room for growth from ESG products. See figure 18. The adoption of taxonomies to track environmentally-oriented products is nascent: 44% of CROs say their banks have taxonomies for some, but not all, green products and services; 40% of all banks and 81% of North American banks are still at an early stage of determining which products and services should be viewed as environmentally oriented. See figure 19.



Figure 18: Which products does your firm view as having growth opportunities associated with ESG?

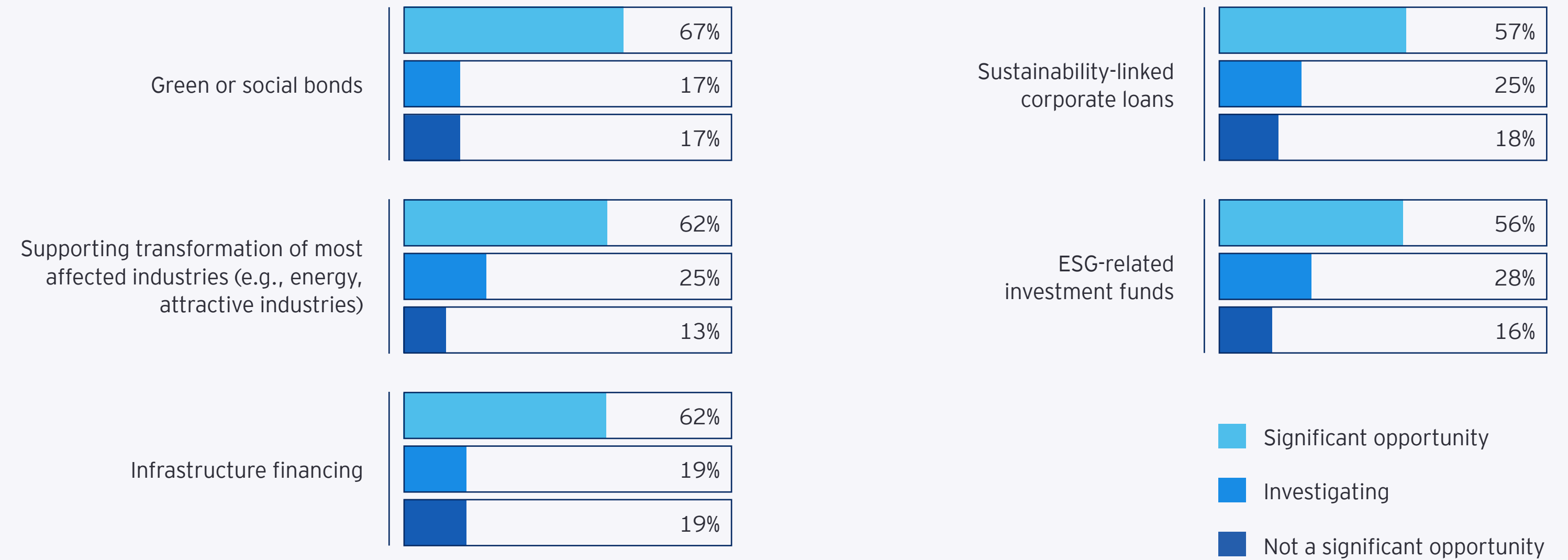
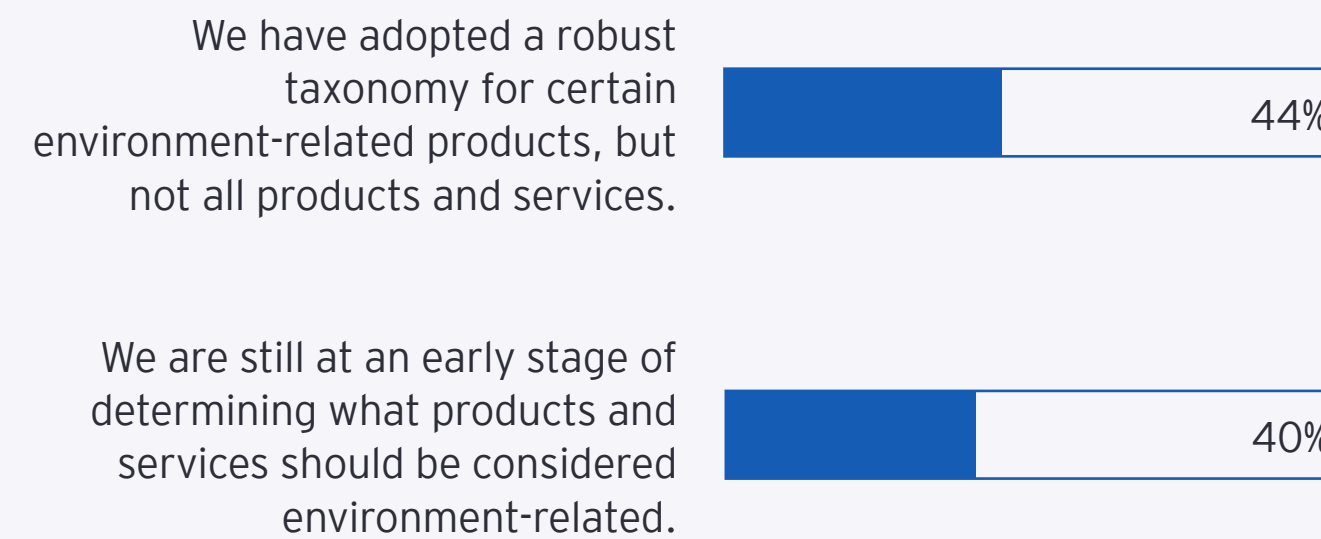


Figure 19: How is your bank tracking which products and services should be considered environment-related?



Seizing sustainable finance and ESG-related growth opportunities requires addressing many factors and variables, including client selection, underwriting processes, risk ratings and pricing. Large banks are leading the way on firm-wide sustainable finance initiatives and show greater current focus on climate risk. However, they are generally not mature in their capabilities yet. It is still very early days for sustainable finance, although we can expect a lot of opportunities and activity in the future.

Chapter 3

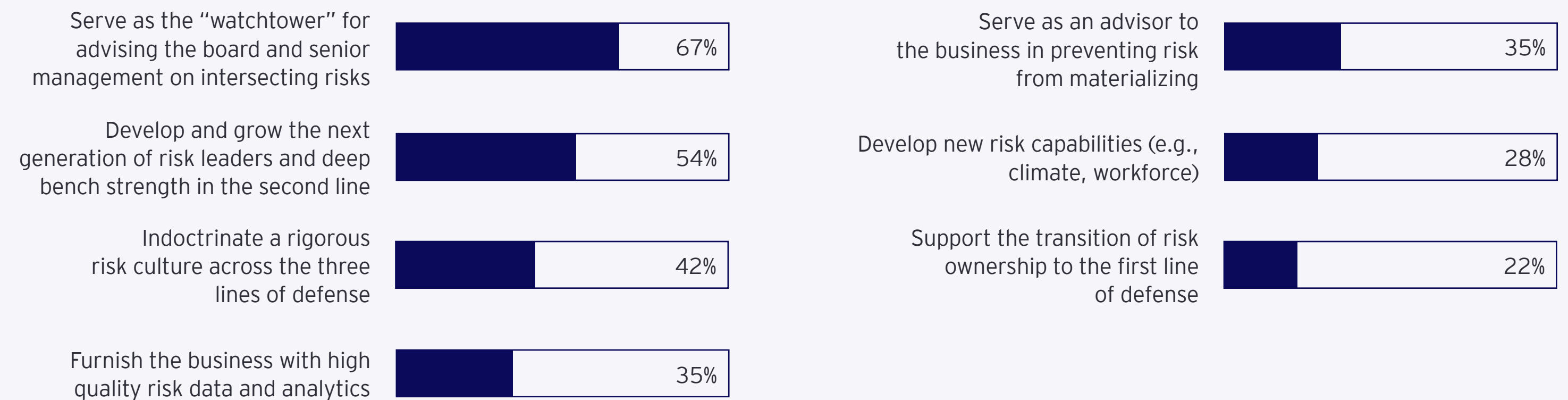
The way forward: building the agile risk management function of the future

To instill the risk management agility the business needs and enable the shift to a more strategic posture, CROs must address multiple dimensions of their operations, including talent and culture, data and technology, and sourcing. However, tight budgets and finite resources mean CROs will have to make choices that map to business priorities but instill flexibility that enables rapid responses as risks evolve and crises emerge seemingly overnight and out of nowhere.

Shifting to the strategic

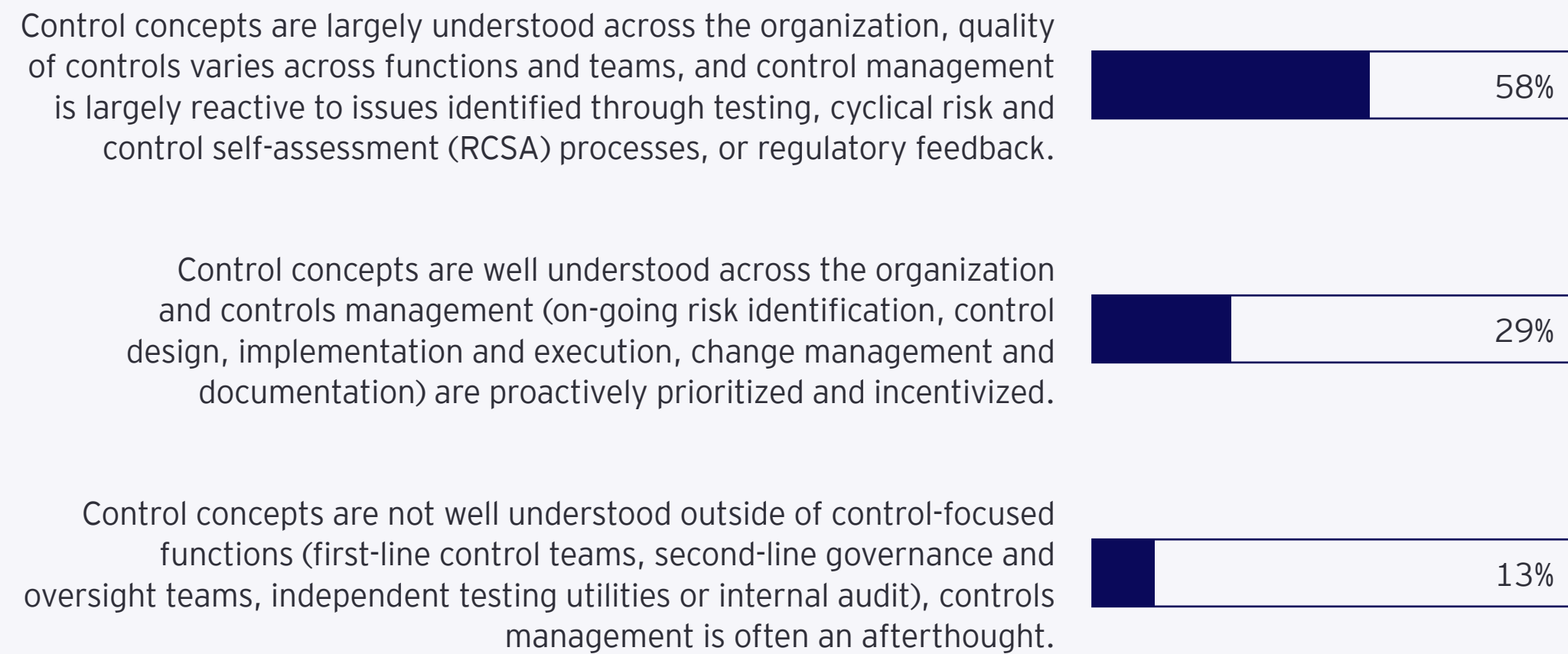
Certainly, CROs expect their role to become more strategic over time, with their “watchtower” function of overseeing and advising on “intersecting risks” becoming more prominent. Leadership development, culture building and business engagement are other areas where CROs expect to invest time and energy in the coming years. See figure 20.

Figure 20: In what areas do you envision the role of the CRO will evolve over the next five years?



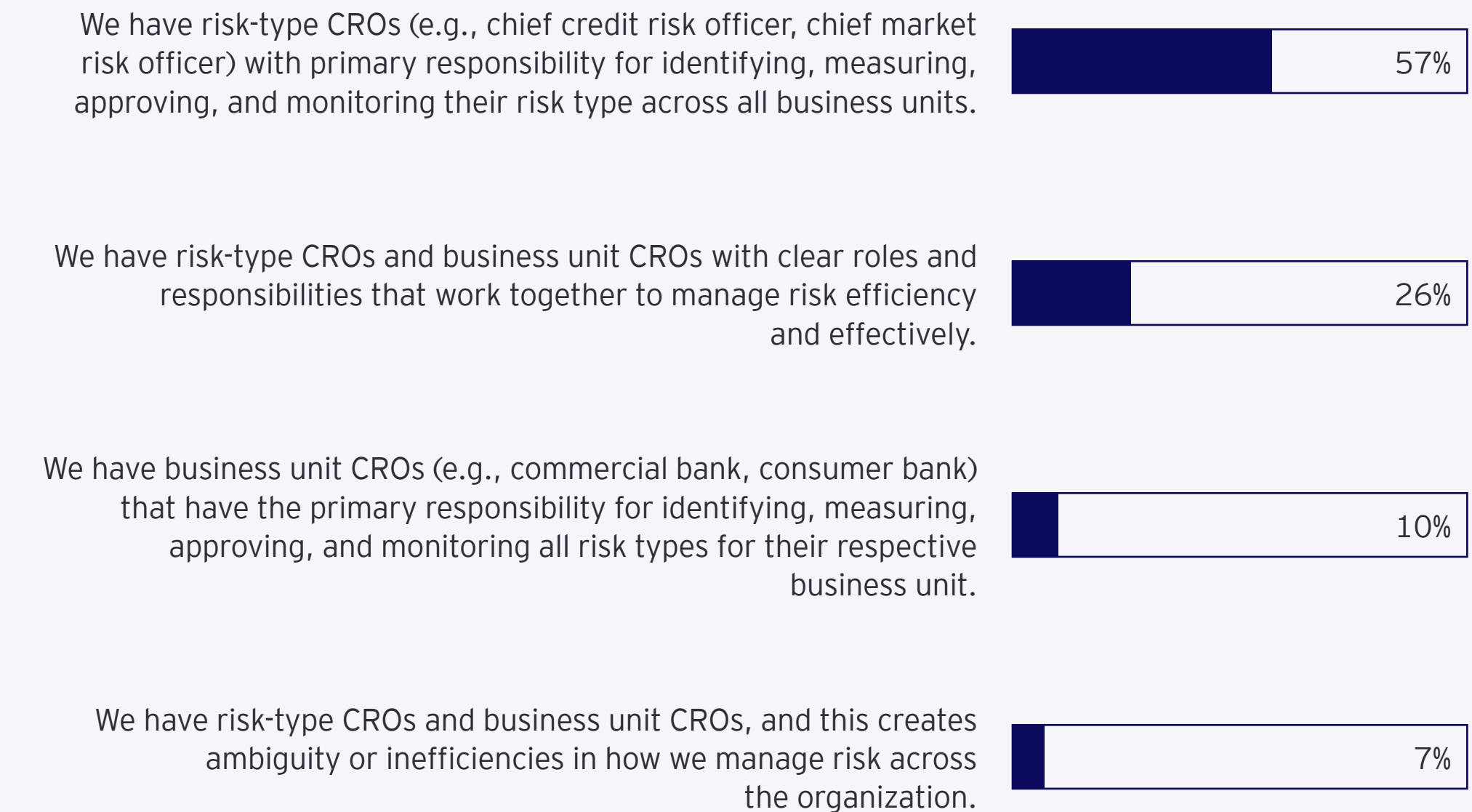
The emphasis on risk culture is timely and necessary, given that most CROs (58%) report a “reactive” stance to controls within their organizations. See figure 21. More proactive mindsets may be necessary to achieve full transformation success and instill the organizational agility that the business needs.

Figure 21: How robust is your organization’s culture around controls?



Initiatives to strengthen risk cultures can be aided by positioning multiple CROs across the organization; the vast majority of respondents say their banks have done just that, in addition to having enterprise-level CROs in place. See figure 22. More than half, 57%, of surveyed CROs say their institution has dedicated leadership by risk type (e.g., chief credit risk officer, chief market risk officer). Another 26%, including 50% of G-SIBs, say they have business unit CROs in addition to risk-type leaders. Very few respondents (7%) report struggling with ambiguities or inefficiencies as a result of having multiple CROs – perhaps because of the growing workload. As both risk types and underlying threat drivers proliferate, banks of all sizes may hire more senior risk leaders to support enterprise CROs.

Figure 22: How are your risk management leadership responsibilities organized?



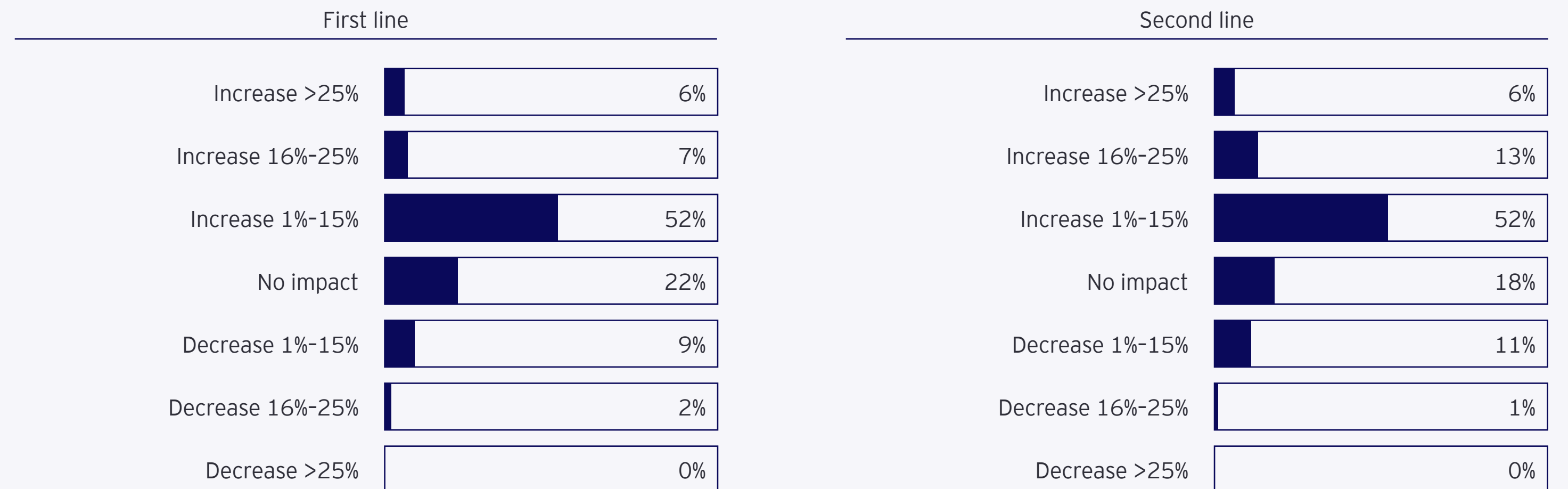


More resources expected in the first and second lines

A majority of banks plan to add risk management resources in both the first and second lines of defense. See figure 23. The largest cohort of CROs is projecting increases of 1% to 15% in both the first and second lines. The fact that the increases in headcount and budget are not larger speaks to perennial cost pressures.

Roughly one in 10 firms is expecting to reduce the size of their risk management teams. Those that are cutting resources are motivated primarily by increased operational efficiencies (according to 54% of CROs), followed by organizational cost reduction strategies (23%).

Figure 23: How do you expect the number of full-time equivalent (FTE) risk management professionals to change over the next five years?



A clear need for new talent

Banks are adding risk management resources because, according to 64% of CROs, they see a need for additional skill sets in both the first and second lines. Only 4% of respondents say their organizations have the skills they need. The greatest needs are in cyber and data science, a continuation of trends from previous studies. The need for liquidity risk is more pronounced this year, especially for smaller banks.

Cybersecurity (cited by 62% of respondents), quantitative analytics (59%) and digital fluency (34%) are the most in-demand skills today. See figure 24. CROs in Latin America (83%) and the Asia-Pacific region (82%) report the greatest challenges in attracting and retaining cyber talent, while North American CROs (48%) are least challenged in finding and keeping cyber professionals. Still, that nearly half of them seek cyber talent speaks to both its scarcity and importance.

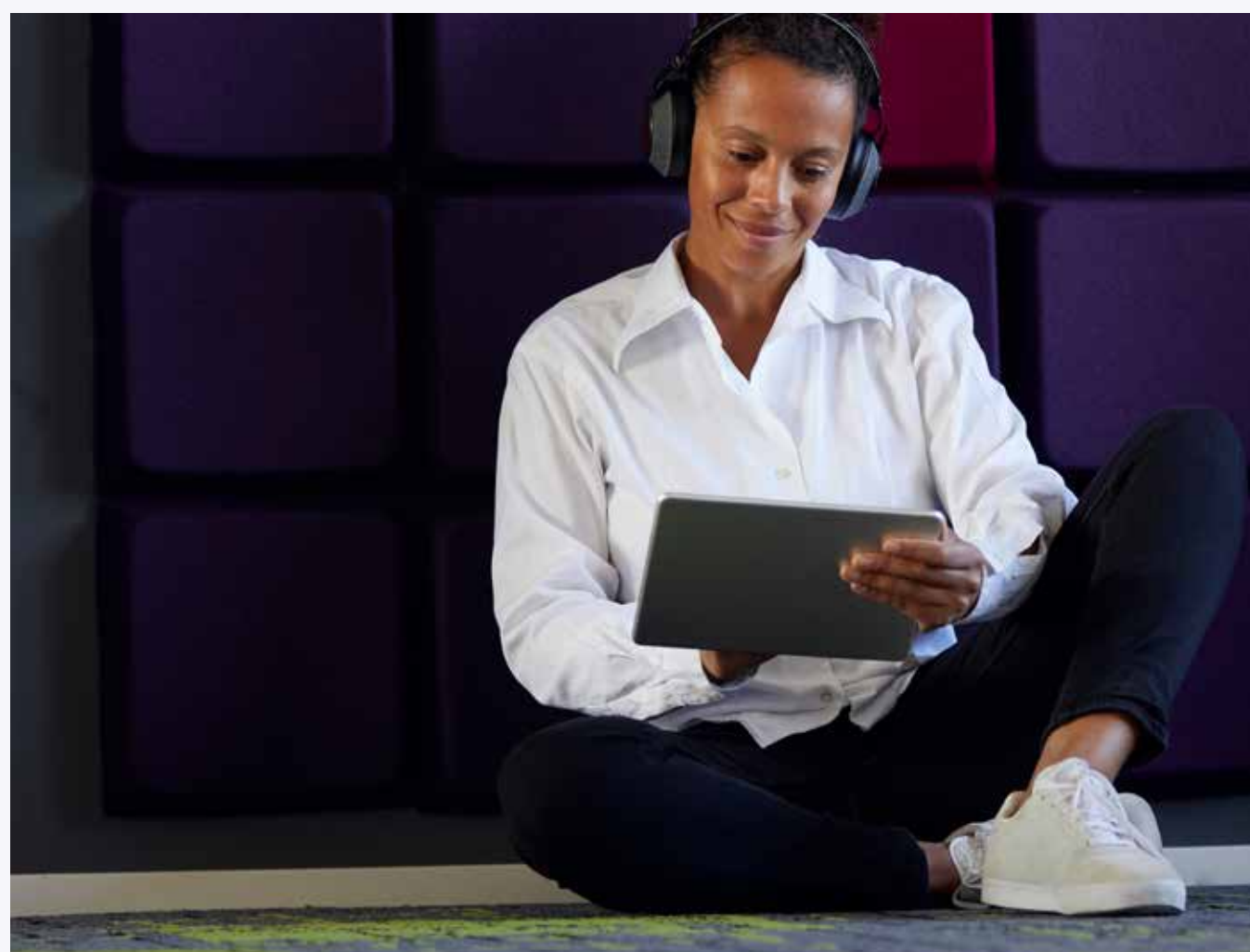


Figure 24: For which skill sets do you currently have the most challenges attracting and maintaining talent?



CROs on talent needs in the first and second lines

64%

Additional skill sets required in both

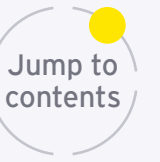
29%

Additional skill sets required in either first or second lines

4%

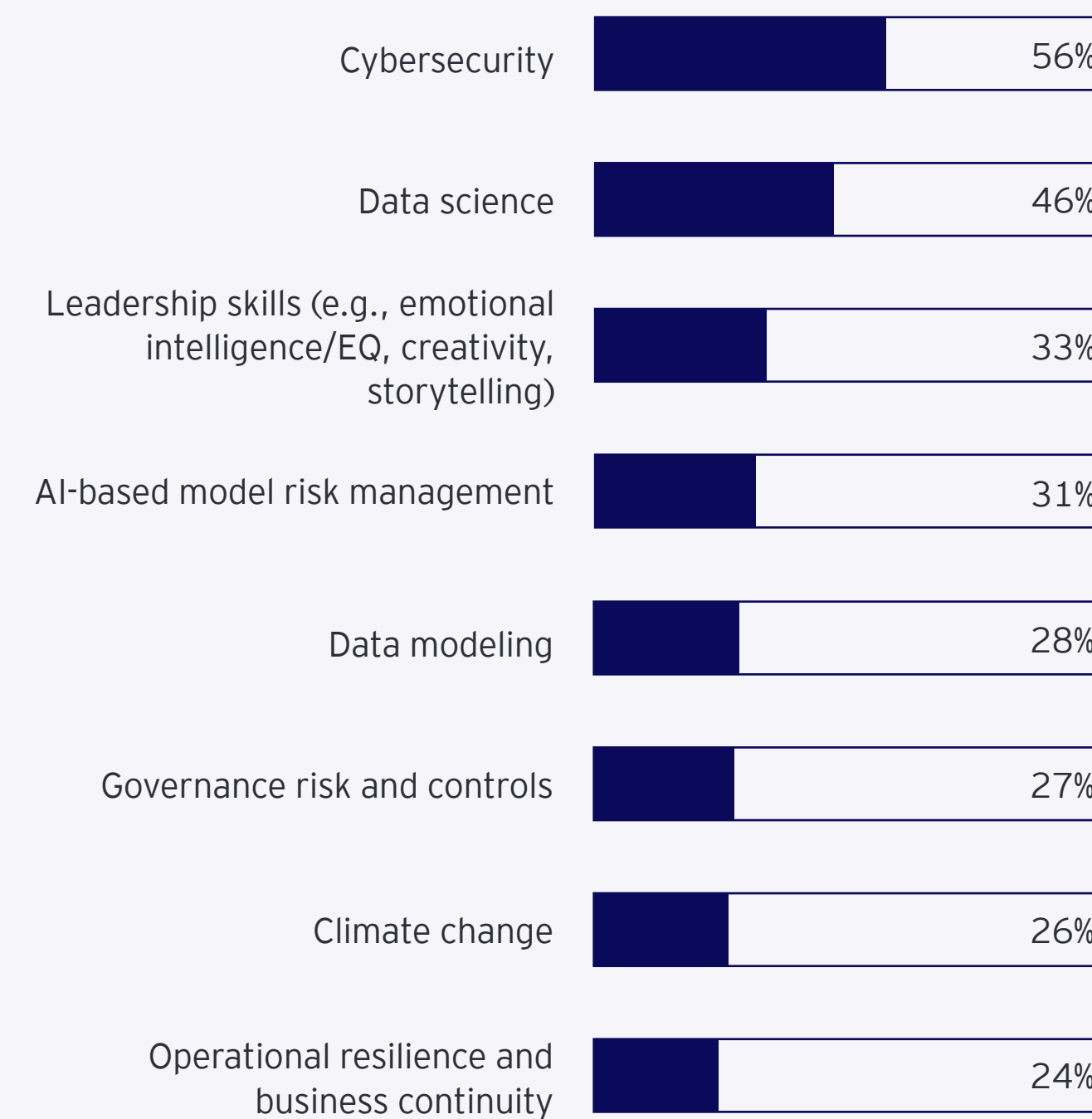
No additional skill set needed in either

Operational resilience and business continuity are perennial first-line priorities and climate risk an emerging one. CROs will be looking to enhance their second-line teams with more talent for AI-based model risk management and data modeling.



Looking out five years, CROs expect cybersecurity (56%) to remain the most important required skill set, which is no surprise given market developments and events. Data science, last year's top choice, dipped slightly to 46%. See figure 25.

Figure 25: What do you see as the most important skill sets required over the next five years?



A third of CROs cited leadership skills as important for the future. Such skills can pay dividends in a time of turbulence and will certainly help CROs play a more strategic role. CROs at G-SIBs (50%) and the largest banks (43%) are most focused on leadership skills. Only 10% of G-SIB CROs cite cyber

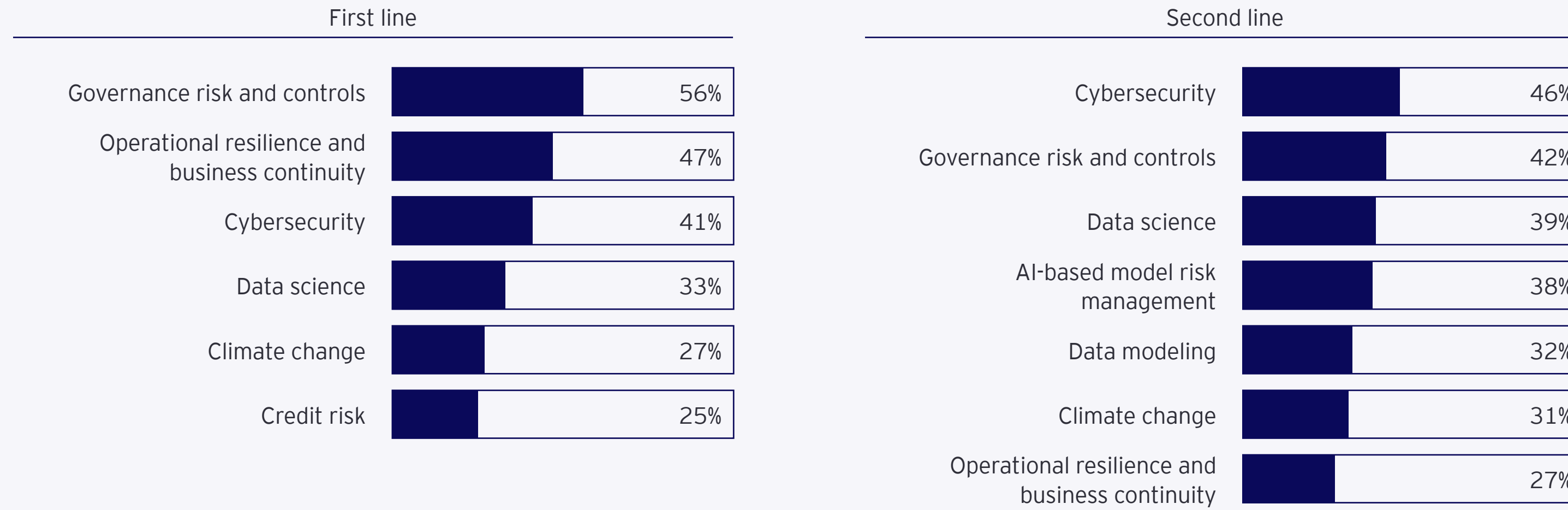
as an important required skill and only 30% say data science will be one. The implication is that they will have engaged the talent they need in these critical areas. And they plan to be more focused on AI-based model risk management (50% versus 31% for all respondents) and governance risk and controls (40% versus 27%).

Latin American (75%) and European (65%) CROs are most likely to expect cyber to still be an important required skill set in five years, while banks in the Asia-Pacific region will be prioritizing AI-based model risk management (55% versus 31% overall). Their peers in North America will prioritize governance risk and controls (52% versus 27% overall).

Looking at the skills needed for each line of defense, there is considerable overlap, which may indicate stronger alignment around common objectives. See figure 26. Results show that CROs want more expertise in cybersecurity, data science and governance risk and controls in both lines. Operational resilience and business continuity are perennial first-line priorities and climate risk an emerging one. CROs will be looking to enhance their second-line teams with more talent for AI-based model risk management and data modeling.

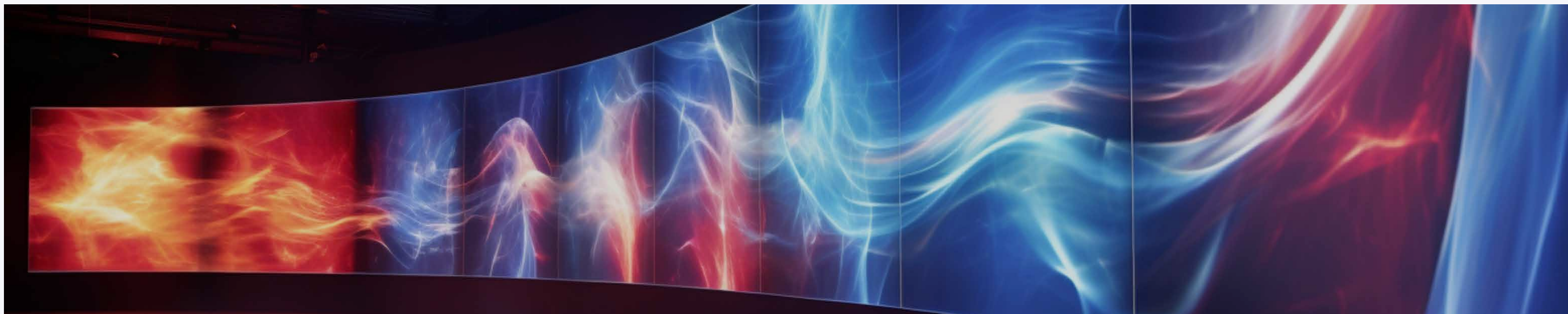


Figure 26: What are the most important skill sets required over the next five years?



In seeking to fill these diverse talent needs, it's clear that banks will need to do a better job attracting future risk managers from the rising generation of workers. Only 43% of CROs said their organizations were very appealing to Gen Z, the demographic cohort roughly born between the mid-1990s to the early 2010s. Nearly a third (30%) said their organizations were not appealing to Gen Z, and 27% said it could be appealing.



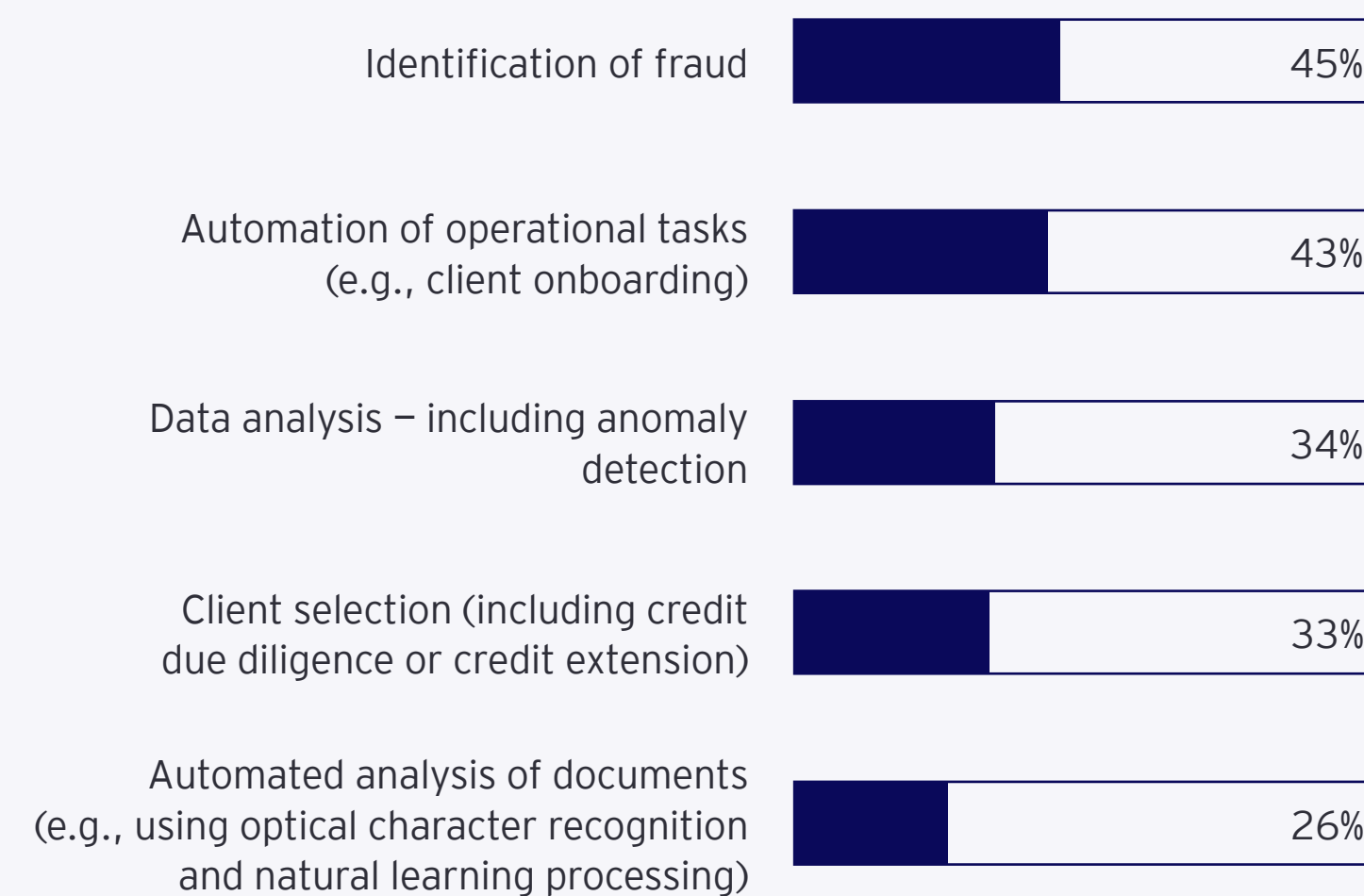


Preparing for the AI era in risk management

GenAI adoption will continue to evolve in the banking industry, both in the business and from a risk management perspective. The prominent position of AI in our survey's ranking of emerging risks reflects the power of the technology itself and the considerable uncertainty surrounding it, including lack of regulatory clarity and limited knowledge of how it works.

Still, significant numbers of risk management teams across the industry are putting AI and machine learning to work, primarily for fraud detection and process automation. AI is also being deployed for analysis of data and documents. See figure 27.

Figure 27: What are the most significant ways your organization is using machine learning (ML) and (AI) – including generative AI?



For risk teams, AI usage is oriented toward operational risk and fraud (cited by 56% of respondents), credit risk (54%) and compliance including financial crimes and consumer compliance (50%). In the future, we expect AI will be used more extensively for monitoring information security (only 33% today) and model risk (20%).

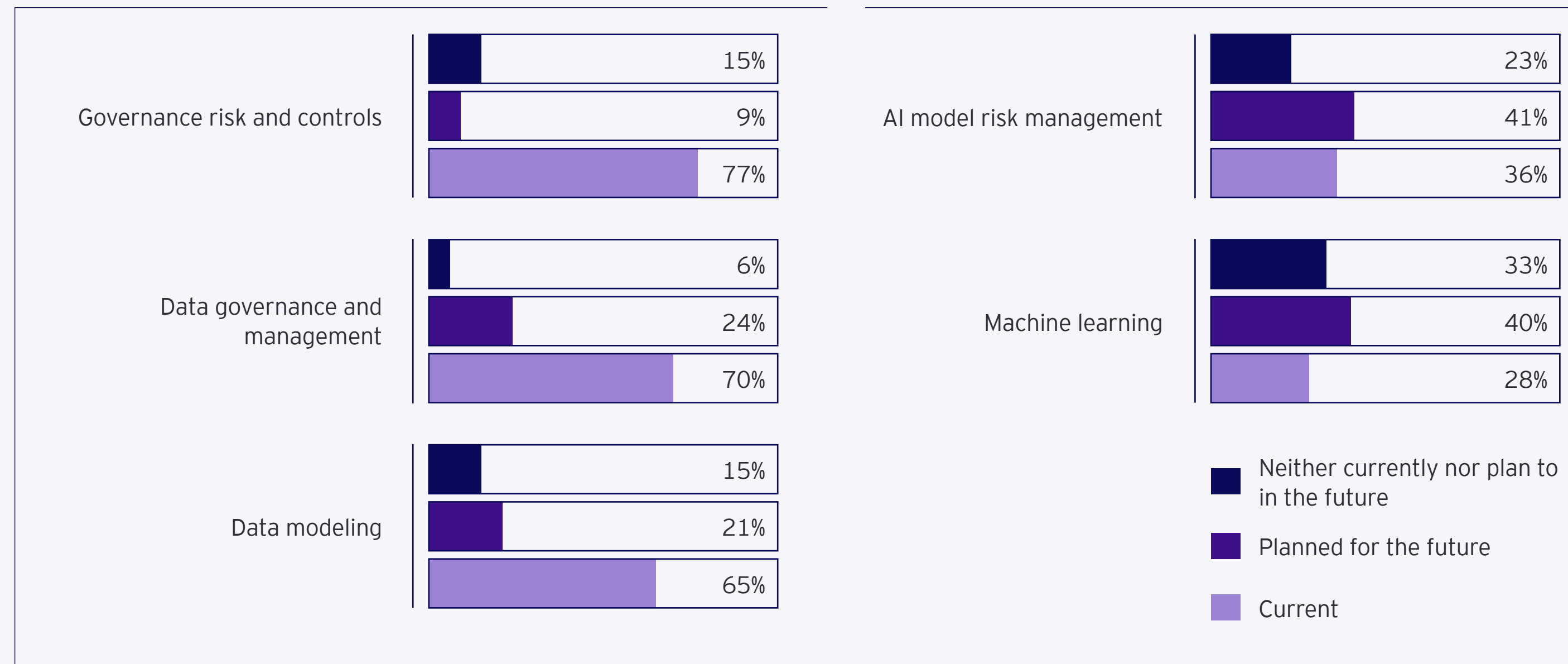
Overall, these use cases mirror the growing consensus among business leaders that internal AI applications are safer starting points in lieu of clearer regulatory direction. It will be interesting in future surveys to see how CROs view AI-associated risks as adoption increases in the business (including more external and customer-facing use cases) and within risk management itself.

Advanced technology is also key to accelerating the digital transformation of the second line of defense. CROs plan to focus on automation (cited by 62% of respondents), enhancing analytics for risk portfolio analysis (46%) and the use of advanced analytics for risk reporting (40%). There's no doubt that the most effective risk management teams in the future will be technology-led and AI-enabled.

Rethinking the sourcing model

In pursuit of more efficient and effective service delivery, CROs continue to explore their sourcing options. Governance risk and controls (cited by 77% of CROs), data governance and management (70%) and data modeling (65%) are the capabilities most commonly delivered via a shared or centralized utility model. AI model risk management and machine learning will soon join that list, given the expectation for increased centralization. See figure 28.

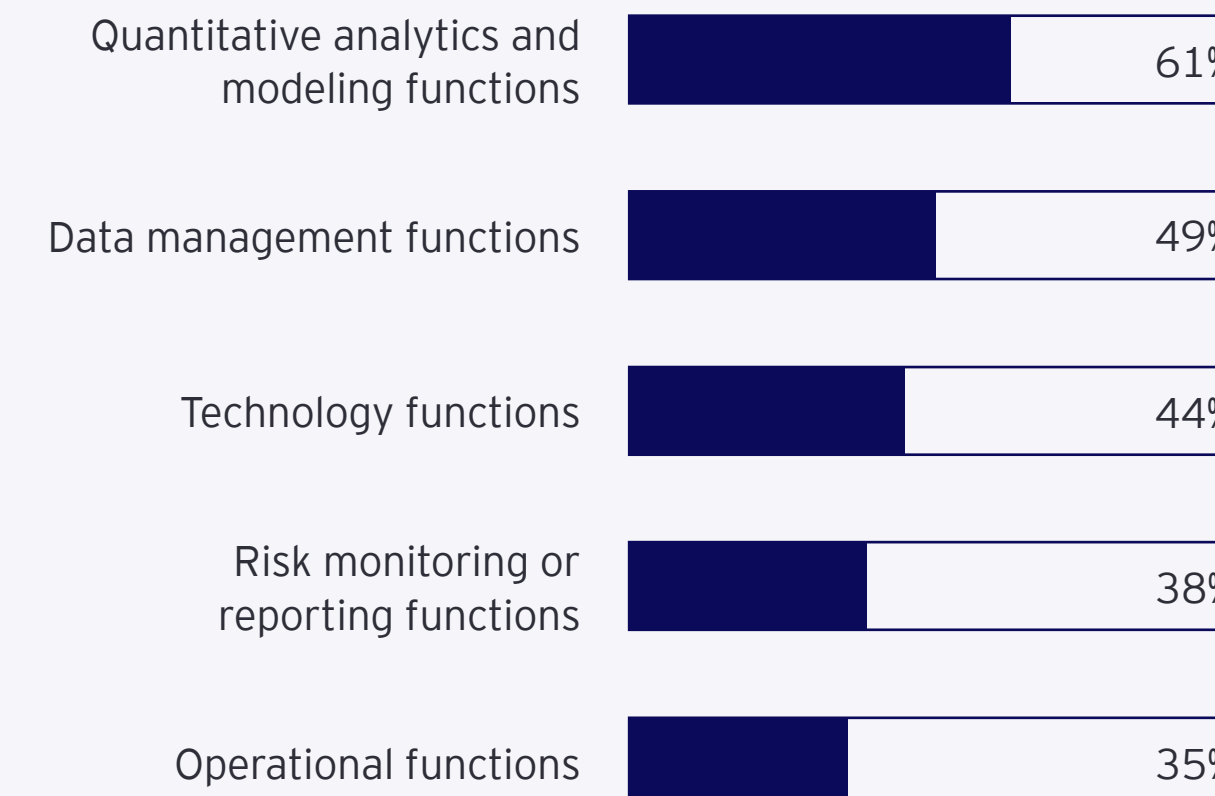
Figure 28: In which functional areas do you currently have a central team acting as a shared utility for common capabilities, and where do you envision establishing this type of shared utility in the future?



Outsourcing and co-sourcing are not widely used today, but CROs expect to expand adoption over the next five years.

Manual processes and tasks, including quantitative analytics and modeling and data management functions, are the most likely candidates for moves to more cost-efficient resourcing models and locations. See figure 29.

Figure 29: What types of risk management roles and functions do you anticipate will have the greatest opportunity to be optimized through a right-shoring or co-sourcing strategy over the next five years?

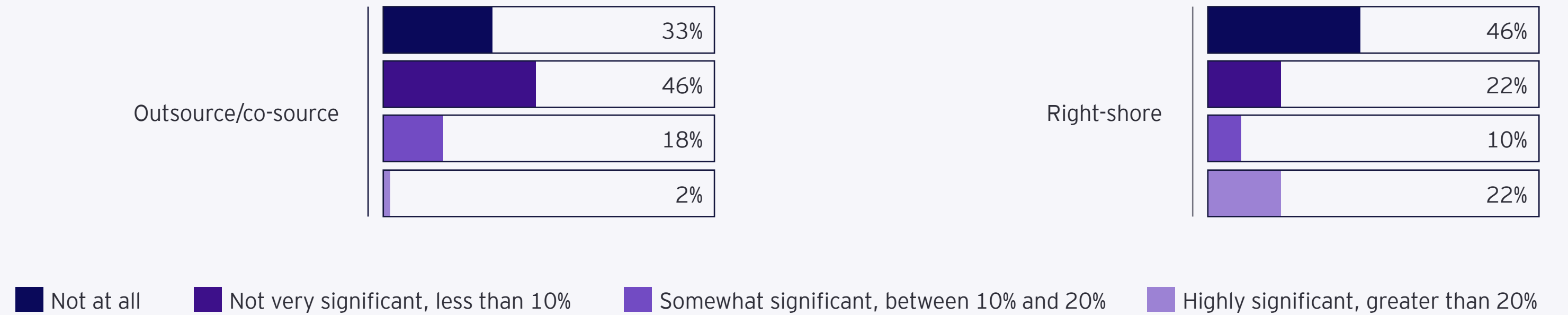


Outsourcing and right-shoring are not significant elements within respondents' current second line of defense talent management, though they will become more significant in the next five years, especially for quantitative analytics and modeling (cited by 61% of CROs as a great opportunity for right-shoring and outsourcing), data management (49%) and technology functions (44%). See figure 30.

Outsourcing and co-sourcing are not widely used today, but CROs expect to expand adoption over the next five years. Only 2% of CROs say it is a highly significant part of their current talent strategies for the second line, with 18% saying it's somewhat significant. Those numbers will jump to 15% and 36% respectively, over the next five years.

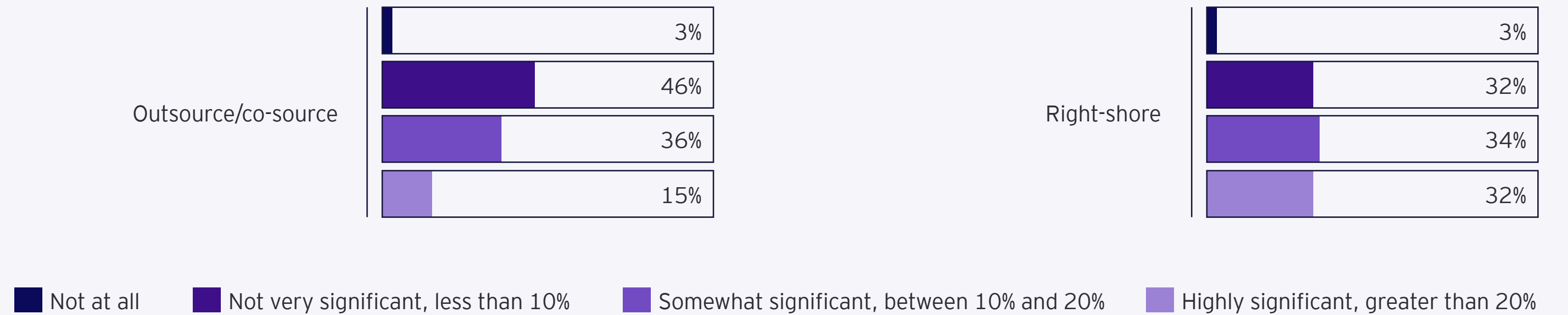


Figure 30: Currently, how significant is right-shoring and outsourcing or co-sourcing as part of your overall talent strategy for the 2LOD risk organization? What percentage of your workforce would you say is right-shored or outsourced?



Right-shoring will also see significant growth, albeit from a somewhat higher baseline. Nearly a third of our survey respondents say it's highly (22%) or somewhat significant (10%) today; in five years, 32% of CROs say it will be highly significant and 34% say it will be somewhat significant. See figure 31. The largest banks will be the largest users of right-shoring. The growth in alternative sourcing reflects CROs' willingness to try different strategies and tactics to navigate budget constraints.

Figure 31: How significant do you anticipate right-shoring and outsourcing and co-sourcing to become as part of your overall talent-strategy for the 2LOD over the next five years?



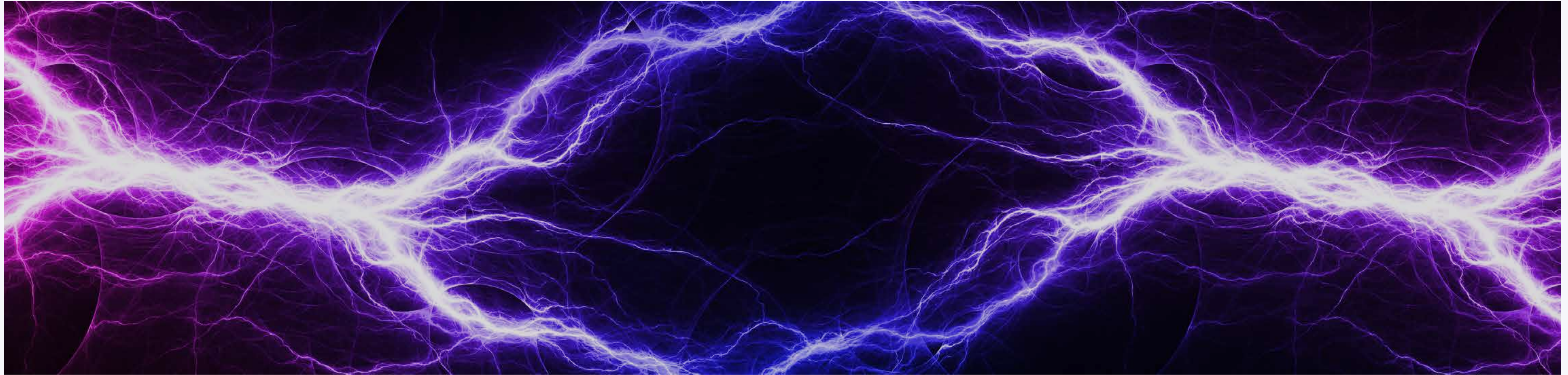
Looking ahead

A brief glance at last year's headlines demonstrates why CROs' jobs have grown more complex and why they're unlikely to get any easier in the coming years. World events, macroeconomic developments, societal megatrends, relentless technology disruption and intensifying regulatory scrutiny — all of these powerful forces directly impact CROs, dictating how they spend their time today and shaping their long-term plans.

Even if they succeed in protecting their institutions against individual threats, they must still account for intricate connections between different types of risks. The need to respond rapidly to sudden emergencies doesn't make proactive, over-the-horizon scanning any less important. In this sense, the CRO role seems to be getting both more strategic and more technical at the same time.

For all of these reasons, we believe organizational agility based on increased data fluency, automation and critical thinking will become hallmarks of high-performing risk management functions in the future. These attributes and capabilities will build on the formidable improvements banks have made in recent years to their risk management practices and control environments. They will also enable CROs to play a broader range of roles more effectively, manage more efficient operations and, ultimately, add more value to the business.

For all of these reasons, we believe organizational agility based on increased data fluency, automation and critical thinking will become hallmarks of high-performing risk management functions in the future.



Research methodology and participant demographic

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 June 2023 through September 2023.

Participating banks' CROs or other senior risk executives were interviewed, completed a survey, or both. In total, 86 banks across 37 countries participated. Participating banks were fairly diverse in terms of asset size, geographic reach and type of bank. Regionally, those banks were headquartered in Asia-Pacific (14%), Europe (21%), Latin America (14%), Middle East and Africa (17%) and North America (34%). Of those, 12% are G-SIBs.

Contacts

EY Global

Jan Bellens
US
jan.bellens1@ey.com
+1 212 360 9098

Christopher Woolard
UK
christopher.woolard@uk.ey.com
+44 207 760 8166

EY Americas

Tom Campanile
US
thomas.campanile@ey.com
+1 212 773 8461

Peter Davis
US
peter.davis@ey.com
+1 212 773 7042

Marlene Devotto
Chile
marlene.devotto@cl.ey.com
+56 229 162 752

Adam Girling
US
adam.girling@ey.com
+1 212 774 9514

Marc Saidenberg
US
marc.saidenberg@ey.com
+1 212 773 9361

Mario Schlener
Canada
mario.schlener@ca.ey.com
+1 416 932 5959

EY Asia-Pacific

David Scott
Hong Kong
david.scott@hk.ey.com
+852 2670 3070

Doug Nixon
Australia
douglas.nixon@au.ey.com
+61 29 276 484

Hyo Bin An
Korea
hyo-bin.an@kr.ey.com
+82 26 119 8858

Jason C Zhang
Mainland China
jason-c.zhang@cn.ey.com
+86 10 5815 3502

Kentaro Ogata
Japan
kentaro.ogata@jp.ey.com
+81 335 031 110

Radish Singh
Singapore
radish.singh@sg.ey.com
+65 6540 7338

EY EMEA

Andrew Duff
London
aduff@uk.ey.com
+44 207 951 7388

Federico Guerreri
Italy
federico.guerreri@it.ey.com
+39 027 221 22326

Bernhard Hein
Germany
bernhard.hein@de.ey.com
+49 711 9881 14338

Stuart Thomson
UK
sthomson@uk.ey.com
+44 131 777 2446

IIF contacts

Andrés Portilla
Managing Director and
Head, Regulatory Affairs
US
aportilla@iif.com
+1 202 857 3645

Martin Boer
Senior Director,
Regulatory Affairs
US
mboer@iif.com
+1 202 857 3636

Hillary Veals
Senior Program
Associate, Regulatory
Affairs
US
hveals@iif.com
+1 202 857 3601

A special **thank you** to the EY core survey team members for their work on the survey, including Vikram Jain, Joseph Mezzadri, Erica Novak, Paul Shahbazian, Hannah Ryan, Matias Djurinsky Zapolski, Alex Treadwell, Maria Mendoza and Josh Austin.



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The Institute of International Finance (IIF)

1333 H St NW, Suite 800E

Washington, DC 20005-4770

USA

Tel: +1 202 857 3600

Fax: +1 202 775 1430

www.iif.com

info@iif.com

