

PRESS RELEASE

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Banking risk landscape transformed, says new survey

'Banana Skins' report identifies top risks facing banks

The turmoil in the financial markets has completely transformed the risk landscape, according to the latest 'Banking Banana Skins' survey conducted by the CSFI in association with PricewaterhouseCoopers.

The annual poll of banking risk is dominated by concerns over current market conditions, notably the liquidity shortage and the crunch in the credit and derivative markets. The fear that these strains will lead to a global recession is high.

The poll is based on the views of nearly 300 senior figures from the financial world in 38 countries, and ranks 30 risks according to their severity.

Two of the top three risks – liquidity and credit spreads – have never previously appeared in the rankings, an indication of how dramatically the risk scene has changed. The only non-financial risk in the top ten is the prospect of a regulatory over-reaction as politicians and regulators prepare to "fix" the problem.

The intensity of respondents' concerns helped drive the Banana Skins Index, which measures anxiety levels in the financial markets, to its highest point since 1998. David Lascelles, survey editor, said: "Although some respondents thought there had been crisis over-reaction, the great majority were very pessimistic. This is the darkest Banana Skins survey in more than 10 years."

Banking Banana Skins 2008

(Previous ranking in brackets)

- 1 Liquidity (-)
- 2 Credit risk (2)
- 3 Credit spreads (-)
- 4 Derivatives (3)
- 5 Macro-economic trends (14)
- 6 Risk management techniques (10)
- 7 Equities (12)
- 8 Too much regulation (1)
- 9 Interest rates (5)
- 10 Hedge funds (7)
- 11 Fraud (11)
- 12 Commodities (4)
- 13 Currencies (13)
- 14 Rogue trader (27)
- 15 High dependence on technology (6)
- 16 Corporate governance (8)
- 17 Management incentives (26)
- 18 Emerging markets (9)
- 19 Back office (24)
- 20 Retail sales practices (22)
- 21 Conflicts of interest (16)
- 22 Political shocks (15)
- 23 Business continuation (21)
- 24 Money laundering (18)
- 25 Environmental risk (25)
- 26 Banking market over-capacity (17)
- 27 Payment systems (29)
- 28 Merger mania (19)
- 29 Too little regulation (30)
- 30 Competition from new entrants (28)

The survey says that the crisis has exposed a failure of controls within banks due to many factors including the growing complexity of finance, distorted incentive structures and insufficient regard to risk management.

John Hitchens, UK banking leader, PricewaterhouseCoopers LLP, said:
“While current market conditions dominate the survey, there is a marked drop in confidence over the quality of bank risk management processes reversing the trend of previous surveys. Respondents clearly believe the credit crunch provides a wake up call for the industry to reassess the effectiveness of its risk oversight.”

Among the fast-rising risks are the threat of global recession, led potentially by a downturn in the US, and a collapse in over-priced equity markets. Concerns about the macro-economic outlook were shared by all the major markets.

The most striking declining risk was over-regulation, which headed the Banana Skins polls for the last two years but fell to 8th place this year. But regulation is still seen as a major risk, particularly if there is a “knee jerk” reaction to the crisis.

The poll showed that only 24 per cent of respondents thought banks were well prepared for the risks they identified compared to 64 per cent in the previous poll. Bankers were more positive than observers and regulators about their ability to weather the storm.

The poll showed variations in the risk outlook as seen by different classes of respondent. Bankers thought market risks posed the strongest threats, notably sharp movements in the credit, derivatives and equity markets. Non-bankers, including regulators, put more weight on weaknesses within the banks themselves, particularly poor risk management and generous bonus systems.

Geographically, industrialised and emerging market economies had a similar focus on crisis-related risks, though the major economies worried more about the threat of over-regulation, and emerging economies about the cost and availability of funding.

Banking Banana Skins 2008 is available (£25, \$50, €40) from CSFI, 5, Derby Street, London W1J 7AB. +44 (0)20 7493 0173. info@csfi.org.uk

Notes to editors:

The Centre for the Study of Financial Innovation, founded in 1993, is an independent not-for-profit think tank based in London which researches the future of financial services. It has an affiliate in New York, New York CSFI. The CSFI has been producing regular Banana Skins surveys since 1996.
www.csfi.org.uk

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