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CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

PRICEWATERHOUSECOOPERS

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Political interference 'now the greatest risk facing the global banking industry'

'Banana Skins' poll identifies top threats to global banking industry

The greatest risk now facing the global banking industry is not financial but political, according to the latest 'Banking Banana Skins' survey conducted by the CSFI in association with PricewaterhouseCoopers.

The annual poll of banking risk puts "political interference" at the top of a list of the 30 most serious risks to banks during this period of financial crisis. The poll is based on responses from 450 senior figures from the financial world in 49 countries, including participants from Bermuda.

Respondents, who include practising bankers as well as close observers of the financial scene and regulators, said that the "politicisation" of banks as a result of bail-outs and takeovers posed a major threat to their financial health.

This view was shared by all types of respondents in all the major banking regions, though for different reasons. Bankers saw politics distorting their lending decisions. Non-bankers said that political rescues had damaged banks by encouraging reckless attitudes. Regulators worried that governments would withdraw their support from banks before they had time to rebuild their financial strength, precipitating another collapse.

Banking Banana Skins 2010

(2008 ranking in brackets)

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

"Political interference" has never appeared as a risk in 15 years of "Banana Skins" surveys. The top risk is closely linked to the No. 3 risk, "Too much regulation", and the concern that banks will be further damaged by over-reaction to the crisis.

David Lascelles, survey editor, said: “It is ironic that politics should emerge as a risk when the banks had to be rescued in the first place. But there is clearly a crisis in the relationship between banks and society, and it will take years to rebuild trust. Until it is, banks will operate under a financial handicap.”

Commenting on the survey results, Andrew Brook, Partner, PricewaterhouseCoopers in Bermuda, said: “The dominant factor shaping risk perception is the state of the world economy. In an era of closely integrated global financial markets, Bermuda is impacted by global economic trends rendering the recent signs of recovery fragile and vulnerable to future shocks.”

Andrew observed a disconnect between the global results of the survey and applicability to Bermuda with regards to money laundering. Once high on the risk agenda, anti-money laundering now barely makes the top 30 global risks. For Bermuda-based companies, however, the strategic focus on this potential banana skin remains strong with the introduction of new legislative initiatives in anti-money laundering regulations and continued focus coming from the International Monetary Fund.

Many of the risks identified by the survey - notably credit risk at No. 2 - stem from concern about the effects of the recession on the banking industry. The bulk of respondents were gloomy about the outlook, fearing a “double dip” recession with a further wave of bad debts hitting the banks. The mood was particularly dark in the Asia Pacific region where respondents are worried that a new asset bubble may burst, bringing about a collapse of confidence in the credit markets.

The poll also reflects concern about the banks’ ability to manage themselves safely. “Banana Skins” such as the quality of risk management, corporate governance and management incentives all feature prominently as potential sources of risk.

But some risks are also seen to be easing as the world pulls out of the crisis. A number of financial risks - liquidity, derivatives, credit spreads and equities – are down on the previous poll in 2008. A striking fall is the risk from hedge funds, down from No. 10 to No. 19, as their threat is seen to diminish. “Financial plumbing” risks are also seen to be low: back office, payments systems etc. All performed well in the crisis. Environmental risk is at an unchanged No. 25 position despite the heat generated by the Copenhagen Summit.

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NOTES TO EDITORS

The CSFI's "Banana Skins" series provides periodic snapshots of the risk landscape in the financial services sector. As well as the banking series, the CSFI conducts surveys of the risks in insurance and microfinance.

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 1995. www.csfi.org.uk

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