



Press release

KPMG: Banks urged to grasp the nettle of risk management to avert repeat crisis

- *Survey indicates too few planning fundamental changes to risk management structure*

Despite the continued fall-out from the financial crisis across the banking industry, it appears that not enough institutions are planning to make fundamental changes to their risk frameworks.

The claim comes from KPMG International as they unveil the findings of a new survey into apparent risk management failures which many in the industry are now coming to terms with.

The results show that 90 per cent of the 400 banking execs surveyed by the Economist Intelligence Unit on behalf of KPMG have carried out – or plan to carry out – a review of the way they manage risk. Yet only 42 per cent of respondents have made – or plan to make – fundamental changes to their risk processes.

This hints at a feeling amongst many banks that the required medicine may not be as severe as some might think – or that the full extent of the fall-out is yet to be realised.

Commenting on the results, Richard Cysarz, Head of Financial Services at KPMG in Central & Eastern Europe said: “This is a timely survey of 500 global banking executives to explore any organizational contributors to the credit crisis. In many CEE countries, having recently reformed the banking sectors, Risk Management and Regulation have in recent times featured more prominently than they may have in the more mature banking sectors of the western world.”

According to Cysarz, the financial sector in Central & Eastern Europe has been fairing relatively well, so far.

“Whilst many of the banking sectors in CEE have undoubtedly been in some way affected by the liquidity squeeze and seismic shifts in foreign exchange rates they have so far managed to largely escape exposures to levels of toxic debt on the scales seen in other countries.”

Nigel Harman of KPMG Advisory and a partner in the UK firm added: “There is little doubt amongst the banks surveyed that a lack of discipline within risk management was a sizable factor behind the credit crisis. However, they seem less forthright in their views on what sort of action this necessitates. What we have is a fairly non-committal response, with just over four out of 10 respondents committing their organisation to the sort of fundamental changes which a crisis of this magnitude merits.”

“On a more positive note, at least the root of the problem is being acknowledged. In the immediate aftermath of the crisis first taking hold, many respondents felt it was all too easy to blame a culture of chasing further revenue in a time of easy credit or remuneration policies which did not encourage sustainable, long-term shareholder value. In some ways, those were red herrings; contributory factors for sure - but factors which should have been addressed, and possibly curtailed, by a robust risk management framework. I believe a key part of the healing process will be to overhaul the whole framework for managing risk; not just to focus on isolated issues. Without that complete overhaul, the risk remains of this happening all over again.”

The KPMG research highlights several areas in which changes will need to be made - the lack of risk expertise at Board level; communication between the risk function and the rest of the business; and the relative lack of influence exerted by the risk function.

The third of these three points can be traced directly back to the fact that 76 per cent of respondents believe that risk is still stigmatised as nothing more than a support function. However, seven out of 10 believe that the function holds more influence than two years ago while even more believe the way they manage risk to be a source of competitive advantage. In addition, Chief Risk Officers are now believed by many respondents to be exerting greater authority over the key areas of strategy development and capital allocation. However, the tag of being a back office, support function should be cast off if the risk function is to progress still further.

The issue of Board level risk expertise appears to be a thorny one. While there is an acceptance of a lack of expertise in this area, few respondents felt it was a serious contributory factor behind the banks’ recent travails. The lack of expertise is even more marked amongst the non-exec director community – yet there appears a distinct lack of appetite for tackling this shortcoming.

As for the communication issue, less than 20 per cent believed a lack of communication across organisational silos to be an important contributory factor. However, further questions revealed problems in communicating risk policies through to an operational level. In this regard, there is possible scope for improved interaction with the business units, as well as with the internal audit team and the audit committee.

Harman continued: “What this research helps to show is that banks should be instilling a robust culture which can address risk governance at all levels. Such a culture effectively requires employees to become risk managers but such a change also requires employees to understand the organisation’s risk appetite. The modern structure for managing risk should be based on three lines of defence; the business unit people ‘on the ground’, the risk management function and then internal audit. For an appropriate culture to come into being, senior management should provide a strong tone from the top. A forthright management lead on this issue can help to reinforce the point that this is no peripheral issue; the handling of which can be delegated to regulators or middle management.”

“Banks should focus on making more qualitative judgements on the risks attached to any major strategic decision. This approach recognises the fact that banking product propositions have now become so complex that quantitative methods on their own may not be able to do justice to a risk assessment in a volatile and unpredictable market.”

“It was poor judgement which brought this crisis upon us – with an apparently excessive focus on short-term gain and a lack of healthy scepticism,” added Mr Harman. “We must therefore hope that levels of judgement take a turn for the better. Grasping the nettle of instilling greater discipline into the risk management process would be a good first step in demonstrating this.”

KPMG in CEE’s Richard Cysarz believes the sector’s global experiences offer food for thought for the financial sector in Central & Eastern Europe. “Organizational contributors of the credit crisis should be of great interest to CEE bankers and regulators in order to continue to avoid any large scale exposure to toxic debts and the vagaries they bring to the sector.”

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