Risk Reward
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New Standards for Risk Management

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THE BANANA SKINS REPORT 2010

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The Centre for the Study of Financial Innovation (CSFI) has recently published its annual "Banana Skins" Survey into the risks facing the banking industry globally. The report surveys a wide range of bankers, regulators and other interested parties and as the editors of the report point out is that what these parties collectively believe could well happen. As such it provides interesting insights into what risks are pre-occupying the minds of those who have and continue to be affected by the biggest financial markets crisis for a generation.

In our opinion it is no surprise that following the level of government intervention required to prop up the financial system globally the number one risk or "Banana Skin" is listed as "Political Interference". Many respondents were reportedly concerned about the political pressure that could be put on bailed out banks to "lend against their better judgement", the distortions that support had created in the market and how it would be gradually withdrawn. In all 30 risks are listed with the top 10 as follows (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)

Whilst perhaps not surprisingly categories such as "Too much regulation" did not appear on the regulators list and "Corporate governance" was much lower for the "the bankers", overall the perceived risks are consistent across all the major banking regions and the different classes of respondent. This probably reflects both the globalisation of markets, the reach of the financial crisis and the overall pessimism reflected in the report about the world economy.

Macro economic trends feature high up in the overall rankings above as a result and the continued high position of credit risk. Concerns about asset quality, leverage and lagging losses are underpinned by fears of the possibility of a "double dip" back into recession globally and the impact that this would have on losses and bank balance sheets.

Credit risk is perceived as the greatest risk in the emerging economies particularly due to a fear of asset bubbles following government stimulus packages. An unwillingness to undertake the write downs necessary was seen as a particular risk in many regions.

Against this backdrop when the report splits respondents into "Industrial countries" and "Emerging economies" different concerns and rankings are apparent. Comparing the two, the report lists the top five risks as follows:

	Emerging economies	Industrial countries
1	Credit risk	Political interference
2	Credit spreads	Too much regulation
3	Macro economic trends	Liquidity
4	Currencies	Credit risk
5	Risk management quality	Macro economic trends

In the emerging economies the risk that spreads would not revert to a more accurate reflection of return for risk was perceived to be higher than for industrial countries. Currency concerns reflect the continued volatility in markets and question marks around the US dollar as a major reserve currency in many of these economies. Concerns around risk management appear to cover a wide spectrum from capability to process, culture and resources and the pressures that cost cutting to shore up banks profitability and capital could bring.

The report presents the survey data well and is careful to leave the conclusions to the reader. It is a thought provoking read and one which will no doubt be helpful to those involved with risk management in financial services in particular.

For a free download of the full report visit http://www.pwc.com/gx/en/banking-capital-markets/banana-skins/banking-banana-skins-2009.jhtml

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