

Industry research report
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MARSH



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New risk management insights for financial institutions





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Introduction

Over the course of the last 24 months or so, there has been extensive analysis of how the risks associated with financial institutions have changed. As each new revelation has entered the public domain, industry experts and media observers have commented in strong terms – telling us why things have gone wrong, who is to blame and how bleak the future looks. In turn, the general public has become much more financially literate, understands much better the cause-and-effect linkages of the global financial and economic crisis and has also become increasingly vocal in its criticism.

Government intervention and the international regulatory response will determine the future look and feel of this industry – everything from the business model to executive remuneration, from increased capital requirements to the payment of dividends. However, what is the industry's own response – how can it repair a battered reputation and restore stakeholder confidence? In the face of such fundamental change, it appears that Board level re-evaluation of risk and a renewed commitment to strengthen risk management practices are among the chosen ways forward.

Yet we know that many risk managers complain that they lack the tools or authority to do their jobs. The danger is that less investment (instead of more) will be made available in an economic downturn and there will be continued pressure to reduce costs whilst maintaining and improving the risk control environment.

In view of the above and in an attempt to move away from the anecdotal, Marsh has surveyed over 120 risk managers working in the financial services industry. The result is one of the most comprehensive risk management studies to have been undertaken among European financial institutions this year. This

research report highlights the key risk management issues of most concern to the industry, the level of confidence shown in managing these issues and the direction that risk management utilisation appears to be taking. Importantly, clients have confirmed that they are increasingly interested in benchmarking their risk management practices against their peer group, whether by performance, investment or best practice.

At Marsh, we recognise that our clients have a rapidly growing register of business risks and they want advice on managing them. We also understand the value that industry expertise brings, both within countries and across an international network. As new risk management practices assert themselves, we are providing our clients with the advice, tools and solutions to make them feel more confident about their future.



Carrick Lambert
EMEA Financial Institutions
Industry Practice Leader

Executive highlights

The downturn in the global economy has been swift and severe. It raises important questions about how organisations conduct their business and particularly about how they assess and manage risk.

To find out how organisations have responded to the downturn, Marsh commissioned Ipsos, an independent research agency, to conduct a survey of risks facing companies in Europe. The survey examined attitudes to risk management in the current economic downturn, including risk priorities, strategy, management and solutions. Ipsos interviewed senior executives responsible for risk management in over 700 organisations, spanning 12 countries and 7 industry sectors. Of these organisations, 121 were financial institutions. This report presents their reactions to the economic downturn and their views on risk management over the next 18 months. The quotes shown throughout this report are actual verbatim responses to questions in our survey.

The industry is responding dramatically and immediately

The financial crisis and the economic downturn have hit financial institutions hard and have highlighted failings of corporate governance and risk culture. Our survey provides dramatic evidence that the industry has recognised its problems and is making solving them a top priority.

Figure 1 compares the results from all seven industries, with exceptionally high or low results highlighted. Barring one indicator, the results from financial institutions stand out, often by a clear margin. For example, the industry believes it has been impacted most by the downturn. It has, by some way, the highest proportion having reviewed their approach to risk. It also has the highest proportion of respondents saying risk management is now seen as being more important at senior levels. It is the industry with the least confidence in its risk management practices, and this has understandably resulted in its decreased appetite for risk. And finally, it has the highest proportion of respondents expecting risk management budgets to rise.

Figure 1: Results at a glance

(Percent of respondents in respective industries)

	FI	CMT	LS	PE	P&U	RCB	T
Impact of downturn perceived to be greatest	64	51	14	35	21	30	54
Reviewed approach to risk	84	71	60	54	66	67	73
RM at senior levels is now more important	87	85	65	56	74	66	77
Risk aversity among Board	52	36	33	25	43	36	40
Retaining more risk	13	18	13	22	13	23	22
Very confident in RM processes	20	25	26	22	36	34	32
Increased budget for RM	47	36	38	25	36	29	30
Group causing most concern	Customers 68	Customers 69	Customers 43	Citizens 54	Customers 49	Customers 55	Customers 62
Most significant risk	Business Continuity 58	Credit 69	Cash flow 78	Environmental 73	Power price 66	Cash flow 76	Cash retention 75

Key: ■ indicates highest percent of respondents, ■ indicates lowest percent of respondents.

CMT: Communications, Media and Technology, FI: Financial Institutions, LS: Life Science, PE: Public Entities, P&U: Power and Utilities, RCB: Retail and Consumer Brands, T: Transport

It's all about liquidity and counterparties. It is more around understanding your data, otherwise you won't be able to draw any meaningful conclusions – and you can potentially burn your bridges with important counterparties.

The most significant operational risks will be business continuity, liability and fraud

Survey participants say that, over the next 18 months, business continuity will be the most significant risk – 58% believe it will be very or fairly significant. “Business continuity” is interpreted in its broadest sense here, referring to the longer-term viability of the industry and/or individual organisations, as opposed to “business continuity management” or “disaster recovery planning”.

The next most significant risks are liability and legal risk (52%) and fraud (44%). Unlike the threat of terrorism or the physical perils that featured prominently in historical risk agendas, these risks arise from reduced liquidity and credit and counterparty risks and manifest themselves differently across specific industry segments.

For banks and mortgage lenders, these risks stem from interbank lending, business failures and defaults on mortgages, loans and credit cards. Investment managers are facing the consequences of poor investment performance, increasing redemptions and the shrinking value of assets under management. Insurers are worried about their investment portfolios, particularly the complex asset classes and the resultant impact on their solvency ratios. The liquidity crunch and the conservative investment environment have also led to a stagnating private equity sector.

Overall, every segment of the industry is concerned about its financial performance, reputational damage and ability to continue business operations. Increased merger, acquisition and divestiture activities, combined with the spate

of part- or full-nationalisations, have impacted industry, market and company stability. Amplifying these challenges, financial institutions are reporting a dramatic increase in litigation and criminal activity, particularly as investors seek to recoup their losses and investigations into poor lending practices reveal increased internal and external fraud.

Budgets are increasing as risk management is overhauled

Budgets for risk management are growing in close to half (47%) of the financial institutions in our survey, with the most commonly mentioned area of increase being recruitment (47%). This is followed by information management systems (42%), training (37%) and risk mapping tools (33%).

The consensus view is that the global financial crisis has revealed a breakdown of certain risk management controls in financial institutions. Recognising this, and in an effort to pre-empt government intervention and mitigate the impact of new regulations, these organisations are set to invest more in improving their overall risk management frameworks in order to avoid similar problems in the future and restore stakeholder confidence.

1. The impact of the downturn

I think risk management will be more vigilant as margins will be under pressure, and we will base our approach more on the products' profitability. It didn't exist before but we're starting to do it now.

The impact of the downturn on the financial sector has been front-page news for the past year and more. We are living through, and dealing with, events that equal in their significance those of the Great Depression of 1929.

Despite the apparent health of the global economy before the crisis, a whole range of untreated problems had accumulated. The US housing market bubble began to deflate in 2006. With the value of property declining, repayment default rates on the mortgages borrowed against them began to rise. The increased delinquency of subprime mortgage borrowers meant that securities backed by these mortgages lost much of their value. These securities were held by financial institutions all around the world and the fall in their value resulted in a general questioning of the value of other similarly complex assets and of the reliability of ratings agencies. This affected the value of any company or institution holding such "toxic" assets, with an inevitable impact on stock market prices.

Taking account of the changes in the value of their assets and the effect of "mark-to-market" accounting standards, banks reported heavy losses that prompted concerns about their viability. Reduced interbank lending threatened runs on banks and significantly reduced the supply of credit. As a result of credit having been cheap for so long, many companies and consumers had come to depend on it, and so the effects of the financial crisis were soon felt in the economy as a whole. To prevent a general breakdown of the world economy, governments acted on an unprecedented scale to ensure that major banks did not fail. Over the past year many banks have been nationalised and governments have borrowed and spent huge sums on stimulus packages to keep people buying, selling, working, borrowing and lending.

Even when this current crisis has passed, its effects will continue to be felt for many years. The speed with which it spread from country to country and from market to market has provided a spectacular demonstration of the extent of globalisation. The world has changed.

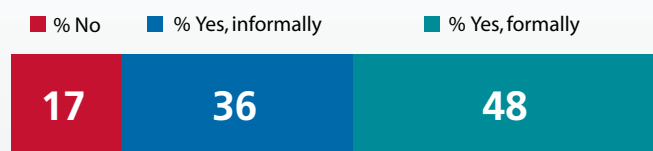
The renaissance in risk management

Governments have intervened on an unprecedented scale and their intervention is now entirely accepted. Discussions at the G20 Summit in April 2009 and elsewhere point to a new regulatory regime that is more global in its reach and more consistent in its application of strengthened policies for sound risk management. New measures have been introduced to supervise previously unregulated entities like hedge funds. Fundamental change did not stop in 2008 – in business practices and business models, in disclosure and in the ways in which financial institutions are able to operate – the change continues.

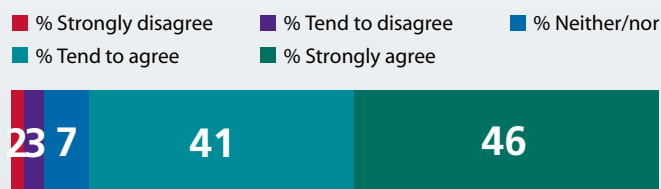
The response from financial institutions has been vigorous. In our survey, 84% of participants say that the downturn has prompted their organisation to review its approach to risk, and 87% say that it has raised the importance of risk at the most senior levels (Figure 2 overleaf).

We are driven by regulatory changes which are prompted by the credit crunch and we are reviewing our capitalisation. We have also been looking at particular business activities and their risk exposures due to trading positions and anticipating changes in the area of remuneration.

Figure 2: Has the economic downturn prompted you to review, formally or informally, your approach to risk?



Would you agree or disagree that the economic downturn has raised the importance of risk management at the most senior levels?



In particular, financial institutions are reviewing their approach in credit and liquidity, investment strategy and counterparty risks. All three are directly related to the downturn – the first to the lack of money circulating and the reluctance of banks to lend; the second to so-called “toxic assets” which are a big part of the investments made by insurance and asset management companies; and the last to the increased danger of third parties being unable to honour a deal because of lack of liquidity or insolvency (Figure 3).

Figure 3: In what areas has the downturn prompted you to review your approach?



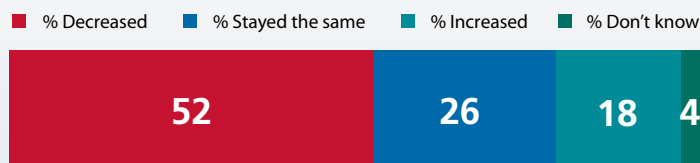
Base: All who formally or informally reviewed their approach to risk (101)

“What we have, we don’t put with one bank. We will divide it and we might possibly put it in state obligations. That way you have more security.”

The downside of greater financial awareness

As a result of these momentous changes and the intense media scrutiny, the public is now much more attuned to the financial sector. The results of this are mixed. People are now much more financially literate and perceptions of the risks associated with financial institutions have been transformed. However, with greater regulation and greater public scrutiny, 52% of respondents say that their Board’s appetite for risk has decreased (Figure 4).

Figure 4: Would you say that the Board’s appetite for risk has increased or decreased in the light of the current economic situation?



Where the Board’s appetite for risk has decreased, respondents say more attention is paid to risk, more controls and reporting are being put in place and there is increased scrutiny of investment projects.

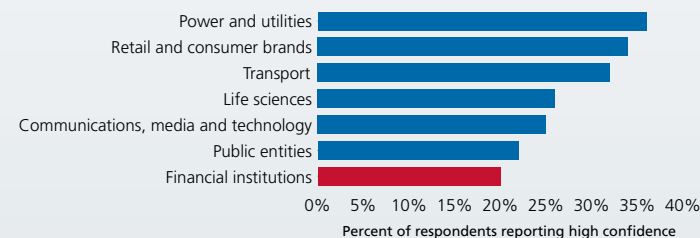
As the financial institutions industry adopts a more “back to basics” approach, these trends suggest that there is a danger of innovation being driven out and

the industry stagnating. This could impair the financial sector’s ability to create wealth, with obvious consequences for jobs and government revenue throughout Europe.

Lack of confidence in risk management processes

It is interesting to compare the different industries’ confidence in their processes for managing risk. For financial institutions, the proportion saying they are “very confident” in their risk processes is the smallest, as Figure 5 illustrates.

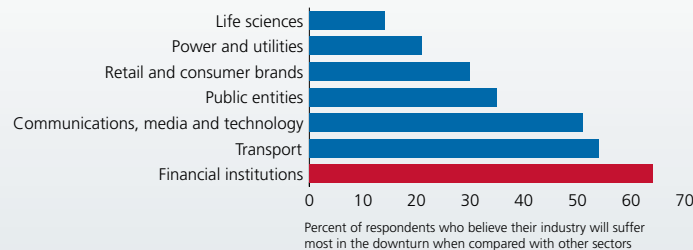
Figure 5: How confident are you in your process for managing risk?



2. The changing risk profile

Of all the seven industries we surveyed, financial institutions say the impact of the downturn has hit them hardest, as is shown in Figure 6. One of the downturn's effects is a transformation of the industry's risk profile.

Figure 6: Financial institutions feel they will be hit hardest by the downturn



Credit risk will be the top priority

When asked about their priorities for the next 18 months, the majority of participants, unsurprisingly, mention financial or macroeconomic risks. Figure 7 shows that two-thirds mention a risk of this type, with credit (37%), liquidity (22%) and the volatility of the financial markets (18%) being the specific risks most often named.

The prominence of credit risk is to be expected given the origins of the financial crisis and the effects of the downturn in reducing the capacity of individuals and companies to obtain credit or to repay debt. With the rise in defaults and

bankruptcies and the scarcity of cash, liquidity risk is bound to be a corollary, especially in combination with the severely reduced levels of interbank lending at the height of the crisis.

Figure 7: Over the next 18 months, which two or three types of risks will be priorities for your organisation?



As volatility increases, hazard risks are overshadowed

The sheer extent of market volatility is also driving a fresh look at priorities for business continuity. Mergers, acquisitions, divestitures and part-nationalisations are becoming almost routine. Big names are disappearing or changing as whole teams and books of business move from one organisation to another. In this environment, the priorities of a year ago,

“We have become stricter. We pay a lot of attention to small signs of worsening and are monitoring arrears more closely.”

such as terrorism and preparedness for hot and cold start centres seem to have been overshadowed by more basic concerns. For disaster recovery planning, hazard risk is still important, but it is no longer the preoccupation it was – only 3% of participants mention it as a key concern.

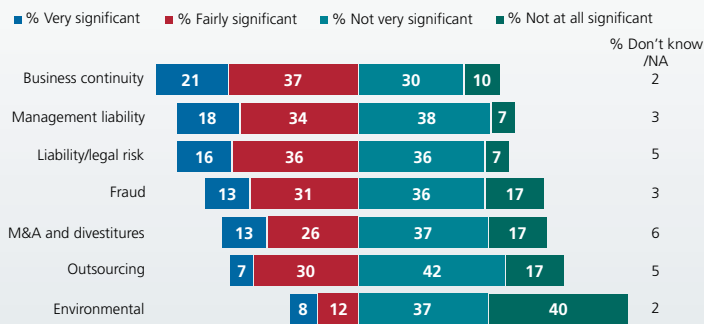
Business continuity, liability and fraud are significant operational risks

Of the seven key operational risks identified in the survey, business continuity emerges as the most significant, with 58% of participants saying it will be fairly or very significant, as Figure 8 shows. The downturn has made lack of liquidity

the most likely cause of being unable to continue in business. For banks and mortgage lenders, the downturn makes default and delinquency over repayment much more likely, particularly as unemployment rises. And for all financial institutions, both investment monies and credit have become scarce, even as their own investments become less likely to perform well. Squeezed between all these pressures, financial institutions have good reason to see business continuity as a significant risk. Interestingly though, only 19% of those who anticipate an increase in the risk management budget mention business continuity planning as an area for spending.

Concerns around business continuity are coupled with those around liability (including management liability and professional liability) and legal risks, which are also seen as priorities. In a downturn, legal action against directors and officers increases as people try to hold someone accountable for the chain of company failures, broken contracts and lost jobs. Management liability and general liability (or legal risk) are rated equally significant by 52% of participants. Nearly 45% of respondents rated fraud a significant concern over the next 18 months, both in relation to the global financial crisis and the fact that such activity is historically shown to increase during any period of economic downturn.

Figure 8: How significant will each of the risks mentioned below be for your organisation in the next 18 months?



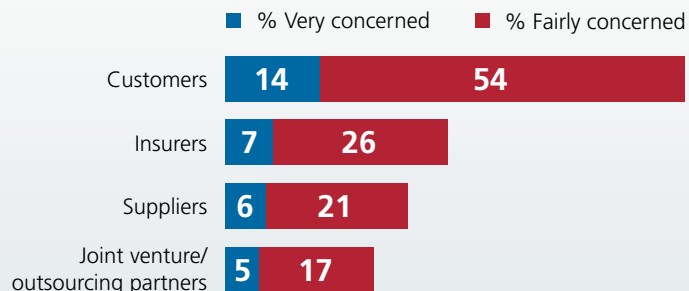
The group causing most concern is customers

With credit risk and business continuity already highlighted as key challenges, it is no wonder that customers are the group that cause financial institutions most concern – 68% say they are very or fairly concerned about them. After all, customers are the group from which the credit risk stems, and their defaults are one of the most likely causes of a financial institution suffering financial difficulties, for example through non-performing loans, bankruptcy or the

“We are reducing exposure by spreading our insurance among more players.”

inability to service a securitised financial instrument. Figure 9 shows how our participants rated their concerns across key business partners.

Figure 9: How concerned are you currently about the level of risk associated with each of the following?



When asked about how financial institutions will manage customer-related risks, the steps most often mentioned are more careful scrutiny and better communication. Figure 10 shows the top approaches mentioned.

Insurers cause less concern than might be expected

Well over half of the financial institutions we surveyed (58%) confirmed that they only use insurance techniques for external risk transfer and that other

Figure 10: What steps are you taking to manage the risks associated with your customers?



mechanisms such as contractual guarantees (7%) and outsourcing (6%) have limited application. Insurers might be expected to be a greater cause of concern from a counterparty risk perspective. Only 33% of participants are concerned about the risk associated with them – although the figure rises to 50% among large companies. The explanation for the relative lack of concern might be financial institutions’ flight to quality in choosing their insurance carriers more carefully over the course of the last 12 months.

The reinsurers have a rating, and we take reinsurers of excellent or very good quality (triple-A or double-A).

Trust is the most important consideration in choosing partners

Concerns about suppliers and partners are even less widespread, felt by 27% and 22% respectively. We believe that the reason for this is that after the panic in the second half of 2008, many economic buyers in financial institutions are taking a step back. They are looking at the organisations they work with – suppliers and joint venture partners – and realising the fundamental importance of trust. They are asking themselves how well they know the organisations with which they work. In some cases, financial institutions have already changed their arrangements to partner with entities that provide much greater financial strength and depth of resources.

In pursuit of trust, we believe financial institutions are now carrying out much more thorough contractual due diligence, so that if problems occur they immediately know what the contract says. They are also putting pressure on their suppliers in order to reduce costs. The relatively low level of concern about suppliers and partners reflects the passing of the panic caused by the downturn. However, financial institutions are undoubtedly looking at all their external dependencies with seriousness.

We are reviewing the contractual relationship on our big project.

We have service level agreements that we review from a risk point of view.

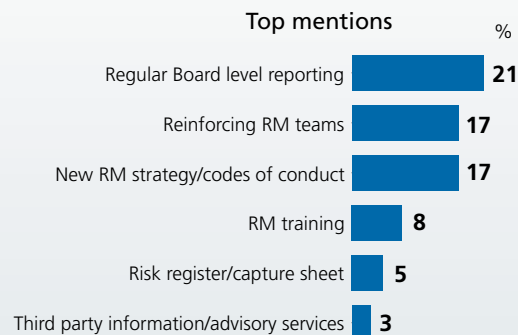
3. The industry's response

[The Board is undertaking a] complete reassessment of strategy in light of the economic downturn, particularly regulatory demands for stress testing.

Board level attention to risk

Figure 11 highlights the actions now being taken and planned by the Boards of financial institutions to improve awareness and understanding of risk in the current environment, and to assist them in more clearly articulating the outlook for the next 18 months. Many senior managers – the directors and officers of the organisation – are acutely aware that their actions are under close scrutiny and that the associated management liabilities present a significant risk to the organisation. Therefore, we can see a renewed interest and commitment by Boards in implementing a broad range of responses to mitigate any actual

Figure 11: What steps is your Board taking now or planning to take to improve awareness and understanding of risk in this current environment?



or alleged wrongful acts by senior management. These include regular Board level reporting (21%), reinforcing risk management teams (17%) and new risk management strategy and codes of practice (17%).

Budget increases demonstrate a new seriousness

Budgets for risk management are expected to grow over the next 18 months in almost half (47%) the companies in our survey. Financial institutions stand out in this regard. The perception, in the industry and beyond it, is that there has been a fundamental failure of corporate governance and risk culture in parts of the financial sector. Many believe this was the cause of the financial crisis and subsequent downturn, so the increase in risk management budgets is seen as a way of restoring stakeholders' confidence and avoiding or pre-empting future problems.

When revenues were growing, profits were healthy and bonuses were generous, there was perceived to be less scrutiny of costs, procedures and controls within financial institutions. Despite key regulatory drivers, such as Basel II, that prompted significant investment in risk frameworks and highlighted the cause-and-effect linkages to capital, many risk managers complained that they lacked the authority to say "no" to senior management or strategic business units, or warn them of excessive risks. In some organisations, the risk management department was seen as the "deal prevention unit". In the last year, however, the perception of risks associated with financial institutions has changed for the worse and therefore risk managers are being given higher profile and renewed respect in their organisations.

The Board has decided to increase the risk control in the bank by employing more people – for credit risk, market and liquidity risk and operational risk.

Regulators have indicated that they will focus more on risk and compliance functions when carrying out inspections and determining capital requirements. In 2008, the UK's Financial Services Authority (FSA) warned banks not to impair "valuation control functions" in cutting jobs¹.

However, this comes at a time when most financial institutions are cutting costs, creating a dilemma for risk managers who are trying to assert their new found authority and improve the quality of risk management. It is important, however, that any inclination towards increasing expenditures points to the seriousness with which the industry plans to deal with the consequences of the financial crisis and strengthen its risk management practices.

There is a widespread determination to overhaul and reinforce risk management departments and, in many cases, this means not only avoiding cutting jobs but increasing the number and quality of risk professionals. It is not surprising to note that, of the participants who say that budgets are growing, the area of increase most commonly mentioned is recruitment (47%), as seen in Figure 12. This is closely followed by information management (IM) systems (42%), training (37%) and risk mapping tools (33%). All these are indicative of a general strengthening of risk management departments. Spending on specific risks is mentioned less. For example, even though business continuity is identified by 58% as being significant, only 19% mention it as being an area for increased spending.

Figure 12: In what areas do you expect the budget for risk management to increase in the next 18 months?



Base: Respondents who say that budgets will increase (57)

At the same time there are some stressed or distressed financial institutions that are seeking to make cost savings across the board. These companies are looking at all linkages in their risk and insurance supply chain to see where money is spent and where it can be saved. Many are analysing their insurance premium spend and testing to see whether their current arrangements continue to be optimal.

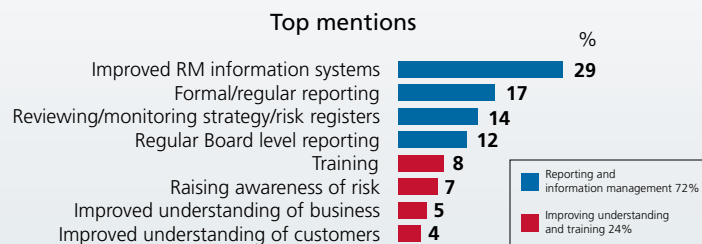
¹ 'Dear CEO' letter, Hector Sants, FSA, 13 August 2008.

[The tools and techniques we use are] native wit and reading the newspapers. It depends on the risk and the size, we don't have management tools for that.

Investing in risk management infrastructure

When asked what steps organisations are currently taking to improve day-to-day risk management, Figure 13 shows that reporting and information management together account for almost three-quarters of responses (72%) and improved understanding and training mentioned by 24%. These results align with the other survey findings that financial institutions are investing in their risk management infrastructure, policies and procedures. The result will be a greater ability to present robust results to stakeholders, particularly regulators and governments.

Figure 13: What steps are you currently taking or planning to take to improve the way your organisation manages risk on a day-to-day basis?



Overall, financial institutions are focusing on information management and reporting. In response to questions about tools and techniques used to identify new risks and improve their understanding of existing ones, participants often mention formal information management and information sharing systems, though a few rely on informal or intuitive methods.

The results presented in Figures 14 and 15 are illuminating. They show that while many techniques are common to addressing both types of risks, the identification of new risks, in general, is more formal and involves using tools, while the understanding of existing risks is less formal and concentrates more on information and processes.

Figure 14: What tools and techniques have you found effective in helping identify new risks?

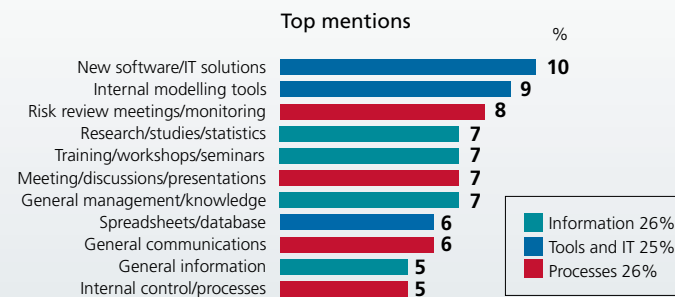
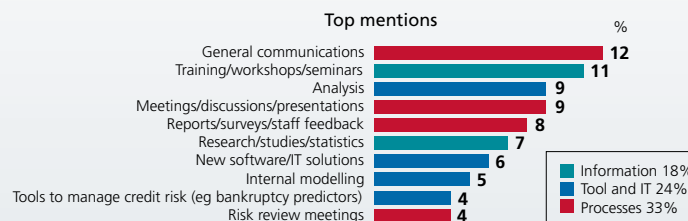
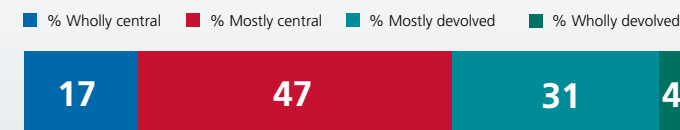


Figure 15: What tools and techniques have you found effective in helping improve understanding of existing risks?



Adjustments to the centralisation of risk management functions in financial institutions may be another sign of a strengthening risk control and reporting environment. Almost two-thirds (64%) of participants say that, their organisation has a centralised approach to risk management. Whether currently centralised or devolved, there is a clear trend for all companies to move to a more centralised model over the coming 18 months.

Figure 16: Which of the following best describes your organisation's overall approach to the management of risk?



We have done a global risk assessment, identified and classified the risks according to a taxonomy shared with all the other company areas. We have identified all the bodies in control of risks and catalogued all the outputs. Gaps have emerged which we will fill, to have a more efficient system.

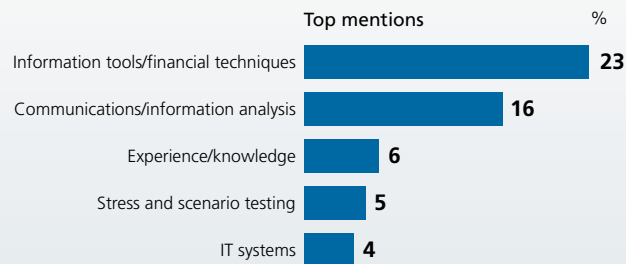
There is little change in risk retention

Over 70% of participants expect the balance between retaining and transferring risk to be unchanged over the next 18 months. This number is even higher among larger organisations, with 93% expecting no change. But all those who expect a change think it will be towards greater risk retention.

[We will retain more risk] on the clients. The current tendency is the withdrawal of client cover by the insurers.

This fits in with our ideas about changes in the pattern of spending. It also fits banks' strategic priorities, which are to preserve capital and to cut costs. Taking risk in-house reduces the cost of risk transfer but puts capital at risk. A balance must be struck between the two considerations, and most banks will be reluctant to change that balance in the current volatile environment. However, where changes are made, there are clear pressures towards improving risk management and retaining more risk. The tools and techniques judged most effective for doing this are set out in Figure 17.

Figure 17: What tools and techniques have you found effective in helping decide levels of risk retention in your organisation?



Regulatory capital relief for a large banking group

Marsh was engaged by the client to

- Align its approach to risk financing and transfer with its group risk framework and underlying risk profiles
- Support the insurance and operational risk teams to successfully apply for regulatory capital relief through insurance.

Deliverables

- Restructured the group insurance programme to enhance protection for the bank against the financial consequences of material operational risks
- Reconfigured the insurance policy coverage to reflect the definitions of risk exposures facing the group
- Enhanced policy performance across the programme in line with the insurance mitigation criteria stipulated in the Basel II accord
- Worked with the bank to calculate regulatory capital haircuts as part of the capital relief submission
- Critiqued the overall methodology and co-presented the regulatory capital submission to the national regulator.

Benefits

- Significantly increased the value achieved from insurance in respect of risk mitigation as part of the group risk framework
- Achieved regulatory capital reductions of the order of tens of millions of Euros.

Recommendations and action

1. Align risk transfer mechanisms with real business risks and objectives

There is no global consistency in the way in which financial institutions approach their risk and insurance arrangements. There are good reasons for this as each organisation will have its own unique business objectives and will need to consider various internal and external risk factors associated with them. These will determine a unique risk profile that must then be matched to risk appetite – both the financial institution's own and that of counterparties or insurers involved in any third-party risk transfer arrangements.

However, many financial institutions have yet to make an explicit link between the purchase of insurance and risk management. Credit and market risks are considered to be the day-to-day business of a financial institution but their inherent linkages to operational risk, from a cause-and-effect perspective, mean that risk transfer techniques such as insurance are valuable tools that could be better employed by the risk management function and also by the various strategic business units.

The result is not only the adoption of global best practice but also aligning the procurement of risk

transfer solutions with business objectives and dealing specifically with business risks. For example, it is still often not the case that operational risk professionals work closely with their insurance procurement colleagues – despite many operational risks being insurable!

Some of the bigger banks, particularly those that have chosen to take the advanced measurement approach under the Basel II accord, have the opportunity to obtain regulatory capital relief for the appropriate use of insurance. However, there are also significant benefits to be had for smaller banks and non-bank financial institutions. For example, organisations can optimise their risk retention/transfer strategy. They can also recognise insurance within their economic capital calculations. We recommend closer working relationships that allow co-development of risk models and integration of risk management efforts.

2. Make the risk function more visible

Financial institutions need to change the way risk management is perceived by their management and employees. The risk management department should not be perceived to be

just a cost centre or “deal prevention unit”, but understood to make a direct contribution to the organisation's performance.

Risk managers should share the lessons learned and benchmarking data from other comparable organisations, for example by being able to access consolidated information on risk management. Building their profile may also involve participating in external networking events or hosting internal seminars that focus on risk management, particularly those that comment on trends or topical issues relating to risk. These could include, for example, focusing on the potential use of insurance as a form of capital that can reduce volatility.

To change attitudes, notable successes should be communicated and publicised within the organisation. For example, if a risk manager can demonstrate that the financial institution has a risk transfer or insurance programme that directly responds to various risk categories then there is the opportunity to release significant amounts of capital for use in other parts of the business. Again, this is especially relevant for those banks that are applying for capital relief under the Basel II advanced measurement approach.

There is another way in which insurance can be used to raise the profile of the risk management department. Insurance has always been used to protect the corporate entity itself but insurance can also be a very powerful way of facilitating corporate transactions and creating value in banks' investment portfolios.

For example, transaction liability solutions can remove various contractual warranties and indemnities in order to facilitate a merger, acquisition or divestment. Similarly, risk managers and insurance buyers can help their organisations apply a risk transfer or insurance technique to improve the day-to-day business and deal flow of a financial institution by means of trade credit, political risk and structured finance insurance.

Risk managers have a unique overview of, and access to, the different parts of their organisation, providing them with much broader risk related knowledge than many of their colleagues or strategic business units. Therefore, as the risk management team becomes more visible, it will be able to create value in more areas of the business. If its involvement in the day-to-day business of the organisation becomes routine, then it can, for example, better understand, and act upon, the implications of any contract the organisation enters into.

Because of the downturn, the door is now opening to risk managers – they are beginning to be seen as something more than bearers of unwelcome news. They must take advantage of this opportunity.

3. Reduce the total cost of risk

Historically, many financial institutions have relied on benchmarking techniques that can be helpful when assessing market or product availability or in conducting a comparative analysis of peer group organisations. A cap on the risk transfer budget will also determine the feasibility of any proposed arrangements. However, in the current environment, we strongly believe that financial institutions need to be more sophisticated in their approach to the procurement of risk transfer solutions. They have to show that they are fundamentally changing their risk management practices, demonstrating a firm understanding of their risk appetite and risk tolerance.

Financial institutions and their advisors need to be more definite about what risks are transferable and then allocate insurance spending or implement controls in the most cost effective way. This involves taking a step back, conducting more thorough due diligence and performing additional analysis of risk trend data in order to make more conscious decisions about which risks should be retained or transferred, in part or in full.

Financial institutions are operating in an expense-conscious environment. But saving costs does not necessarily mean buying less or even no insurance, particularly if subsequent losses or claims result in the erosion of capital that could have been substituted by a more efficient risk transfer mechanism. As previously stated, insurance related techniques can reduce potential volatility.

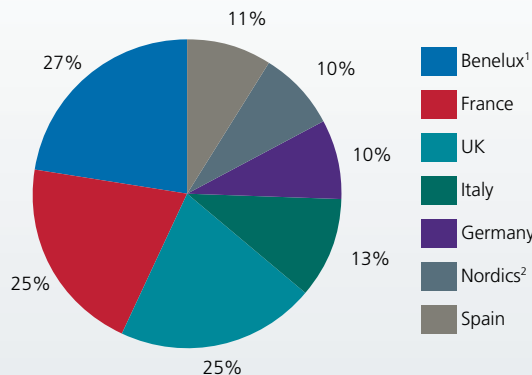
For example, a review of a self-insured retention might actually conclude that the enlargement of the risk transfer mechanism or insurance programme could reduce the total cost of risk. As part of this process, we believe that risk managers need to implement tools and mapping processes to help the organisation understand its risks.

Alternatively, it may be the case that a more forward-thinking analysis of the insurance procurement process can deliver cost synergies based upon various stress tests applied to the supply chain linkages.

Research methodology and respondent profile

Our survey of over 700 participants in seven industry sectors included 121 participants from financial institutions. These participants all contribute to strategic decision making related to their organisation's management of risk. The survey was conducted across five countries (France, Germany, Italy, Spain and the United Kingdom) and two sub-regions (Benelux and Nordic countries). The organisations surveyed all have a turnover greater than £50 million and were selected through random sampling using Bureau van Dijk, an international business database. The interviews were conducted by telephone in local languages between 11 March and 9 April 2009.

Figure 18: Breakdown by geography



¹ Includes Belgium, the Netherlands and Luxembourg
² Includes Denmark, Finland, Norway and Sweden

Figure 19: Breakdown by job title

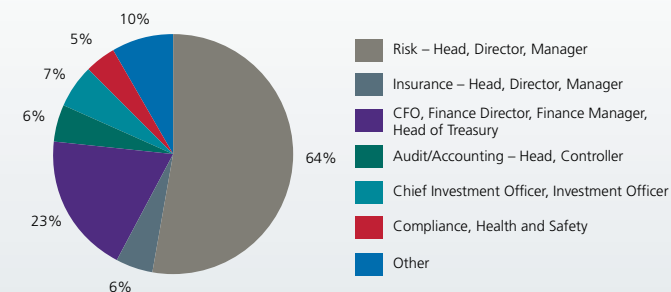
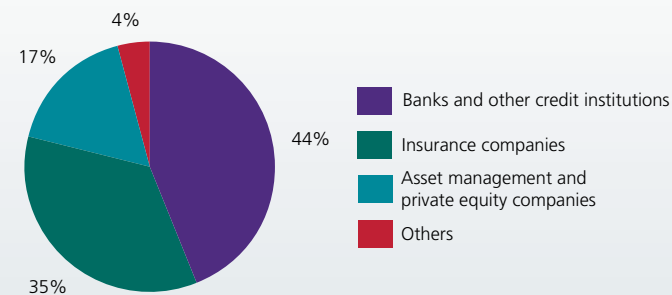


Figure 20: Breakdown by industry sub-segment



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Our Europe, Middle East and Africa Financial Institutions Industry Practice is part of a global network providing risk management solutions to the financial institutions industry. Our clients include 11 of the global top 20 banks, 20 of the European top 50 banks, 14 of the global top 20 private equity firms and 18 of the 54 financial institutions listed in the FTSE 250.

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