Executive Perspectives on Top Risks 2023 & 2032

Macroeconomic and labor market headwinds shape Financial Services Industry risk environment in 2023, with adoption of digital technologies chief risk driver for 2032

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The level of uncertainty in today's global marketplace and the velocity of change continue to produce a multitude of potential risks that can disrupt an organization's business model and strategy on very short notice. Unfolding events in Eastern Europe, changes in government leadership in several countries around the globe, escalating inflation, rising interest rates, ever-present cyber threats, competition for talent and specialized skill sets, continued disruptions in global supply chains, rapidly developing technologies … these represent just a sampling of the complex web of drivers of risks that may threaten an organization's achievement of its objectives. Uncertainty and risk are here to stay. Keeping abreast of emerging risk issues and market opportunities is critical to improving organizational resilience.

The need for robust, strategic approaches to anticipating and managing risks cannot be over-emphasized. Boards of directors and executive management teams who choose to manage risks on a reactive basis are likely to be left behind those who embrace the reality that risk and return are interconnected and recognize the benefits of proactively managing risks through a strategic lens. Those leaders who understand how insights about emerging risks can be used to navigate the world of uncertainty nimbly increase their organization's ability to pivot when the unexpected occurs. That can translate into sustainable competitive advantage.

In this 11th annual survey, Protiviti and NC State University's ERM Initiative report on the top risks on the minds of global boards of directors and executives in 2023 and over the next 10 years. Our respondent group, which includes 1,304 board members and C-suite executives from around the world, provided their perspectives about the potential impact over the next 12 months and next decade of 38 risk issues across these three dimensions:[1]

- **Macroeconomic risks** likely to affect their organization's growth opportunities
- **Strategic risks** the organization faces that may affect the validity of its strategy for pursuing growth opportunities
- **Operational risks** that might affect key operations of the organization in executing its strategy

[1] Each respondent rated 38 individual risk issues using a 10-point scale, where a score of 1 reflects "No Impact at All" and a score of 10 reflects "Extensive Impact" to their organization. For each of the 38 risk issues, we computed the average score reported by all respondents.

Commentary – Financial Services Industry Group

Growing concerns about economic conditions and ongoing talent market challenges headline this year's list of top risks for financial services executives, as the pandemic fades in importance.

Our 2022 Top Risks Survey showed a financial services industry that was clearly seeing the light at the end of the COVID pandemic tunnel and eager to return to more normal business conditions. On the other hand, respondents to last year's survey noted growing concerns about the interest rate environment and ability to compete for talent in a highly competitive and unusual labor market.

This year's survey results largely cemented those concerns as inflation continued to accelerate and central banks aggressively raised interest rates and unwound monetary stimulus programs in response. As a result, the likelihood of a global economic recession increased. At the same time, and somewhat unusually given softening economic conditions, many financial institutions are still understaffed and struggling to attract and retain talent.

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate[2]	US FSI Unemployment Rate[3]
12/14/22	+50	4.25%-4.5%	N/A
11/02/22	+75	3.75%-4%	1.9%
09/21/22	+75	3%-3.25%	1.3%
07/27/22	+75	2.25%-2.5%	1.6%
06/16/22	+75	1.5%-1.75%	2.1%
05/05/22	+50	0.75%-1%	1.9%
03/17/22	+25	0.25%-0.50%	2.0%

Accordingly, the overall 2023 top risks were generally consistent with those noted last year. Concerns about the interest rate environment ranked as the top risk in both 2023 and 2022. Four of the top five risks from last year remained in the top five this year, although a few traded places. Surprisingly, the risk tied to inflation and economic conditions more broadly dropped from second to third, and the average score for this risk fell slightly as well.

[2] Federal Funds Rate History 1990 to 2022, Forbes Advisor, November 2, 2022, www.forbes.com/advisor/investing/fed-funds-rate-history/.

[3] Unemployment Rate - Financial Activities Industry, Private Wage and Salary Workers, FRED Economic Data, https://fred.stlouisfed.org/series/LNU04032238. N.B.: U.S. data is used as global proxy based on availability of global data, though the U.S. is not the largest financial services market globally.

	Top Risks YoY		
Rank[4]	2023	2022	2023 Risk Change in Rank
1	The current interest rate environment may have a significant effect on the organization's capital costs and operations	The current interest rate environment may have a significant effect on the organization's capital costs and operations	-
2	Our organization's succession challenges and ability to attract and retain top talent and labor amid the constraints of a tightening talent/labor market may limit our ability to achieve operational targets	Economic conditions (including inflationary pressures) in markets we currently serve may significantly restrict growth opportunities, impact margins or require new skill sets for our organization	+2
3	Economic conditions (including inflationary pressures) in markets we currently serve may significantly restrict growth opportunities, impact margins or require new skill sets for our organization	The adoption of digital technologies (e.g., artificial intelligence, automation in all of its forms, natural language processing, visual recognition software, virtual reality simulations) in the marketplace and in our organization may require new skills that either are in short supply in the market for talent or require significant efforts to upskill and reskill our existing employees	+1
4	Ensuring data privacy and compliance with growing identity protection expectations and regulations may require alterations demanding significant resources to restructure how we collect, store, share and use data to run our business	Our organization's succession challenges and ability to attract and retain top talent and labor amid the constraints of a tightening talent/labor market may limit our ability to achieve operational targets	+7
5	Regulatory changes and scrutiny may heighten, noticeably affecting the way our processes are designed and our products or services are produced or delivered	Regulatory changes and scrutiny may heighten, noticeably affecting the way our processes are designed and our products or services are produced or delivered	-
5	Inability to utilize data analytics and "big data" to achieve market intelligence, gain insights on the customer experience, and increase productivity and efficiency may significantly affect our management of core operations and strategic plans		+2

There were a few other noteworthy results in this year's survey, including:

- Although global financial volatility and foreign exchange rates moved up the list (10th place this year vs. 21st last year), we were surprised this risk didn't rank even higher given the dramatic F/X fluctuations we've seen

[4] Results for 2023 indicated a tie for the fifth-place Top Risk.

over the past 12 months and the impact those results have had on U.S. institutions with significant global operations, particularly in Europe. Over the course of 2022, the British pound fell from a high of $1.34 against the dollar to a low of $1.12. Similarly, the euro fell from a high of $1.12 against the dollar to $0.98.[5]

- Other responses signaled growing wariness about economic conditions. For example, although still relatively low on the list at 20th place, liquidity and capital risks jumped 12 spots this year.
- Concerns about privacy and identity protection compliance jumped significantly in the ratings, moving from the 11th spot in 2022 to fourth place in 2023. However, the absolute score for this risk changed only slightly, making the move more a function of other risks dropping in priority than the industry significantly elevating its focus on privacy compliance this year. Interestingly, though, concerns about privacy significantly trumped security (ninth place last year and 11th place this year). We would have expected the opposite given the wide range of security threats and challenges the industry continues to face — from regulators' high and increasing focus on cyber resiliency to geopolitical tensions driving nation-state hacking, and high-profile wallet thefts from digital assets exchanges, among many other issues.

Risks related to the transition to hybrid work and ongoing increases in the cost of labor increased significantly year over year. We would expect this set of risks to decline by the time of our 2024 survey as the crypto implosion and layoffs and hiring freezes across the technology industry reduce a source of competition for FSI talent.

Another dominant theme throughout this year's results was the ongoing tightness of the labor market. The ability to attract and retain talent moved up two spots to No. 2. Access to IT talent and digital knowledge moved up five spots to No. 7. Risks related to the transition to hybrid work and ongoing increases in the cost of labor also increased significantly year over year. We would expect this set of risks to decline by the time of our 2024 survey as the crypto implosion and layoffs and hiring freezes across the technology industry reduce a source of competition for FSI talent. Meanwhile, headcount reductions in areas like mortgage lending and investment banking are starting to increase the supply of available candidates across the broader financial services industry.

Finally, this year's results confirmed that the financial services industry has moved on from COVID, at least in most parts of the world. Concerns about government mandates and restrictions, ability to protect the health and safety of employees, and the possibility that the pandemic would drive negative shifts in customer spending patterns all fell significantly, and collectively accounted for three of the eight lowest-rated risks in this year's survey. Importantly, though, our survey was conducted before the abrupt end of China's Zero-COVID policies in December of 2022. We expect this change to create uncertainty and disruption in Asian financial markets – and global supply chains – throughout Q1, and then for China to follow the rest of the world in returning to the "new normal" gradually over the remainder of 2023.

The results for the 10-year risk outlook are very similar to last year's. The top five risks for 2032 include the adoption of digital technologies and the rapid speed of disruptive innovations as well as risks related to talent, data privacy and regulatory change, which also rank among the top five risks for 2023. Four of the top five 2032 risks — all but regulatory change — are rated at the "Significant Impact" level. Compared to the 2023 risk outlook, in which there are no risks rated at that level, the 2032 results suggest that board members and executives in the industry group see a riskier outlook for the next decade.

[5] XE Currency Charts, https://www.xe.com/currencycharts/.

FIGURE 21B

Financial Services — 2032

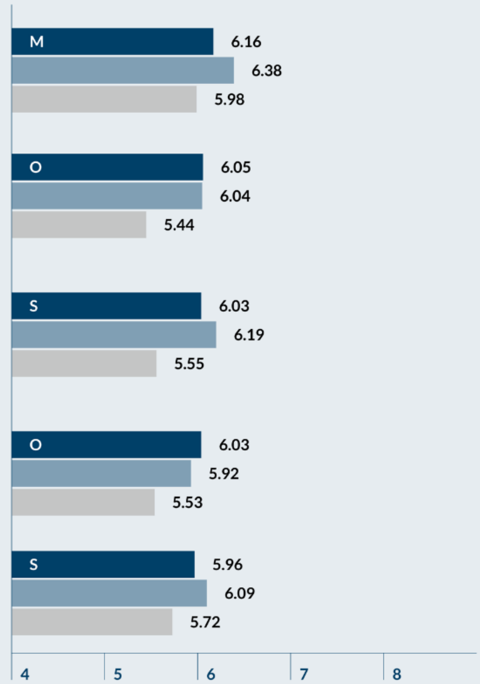
The adoption of digital technologies (e.g., artificial intelligence, automation in all of its forms, natural language processing, visual recognition software, virtual reality simulations) in the marketplace and in our organization may require new skills that either are in short supply in the market for talent or require significant efforts to upskill and reskill our existing employees

Our organization's succession challenges and ability to attract and retain top talent and labor amid the constraints of a tightening talent/labor market may limit our ability to achieve operational targets

Rapid speed of disruptive innovations enabled by advanced technologies (e.g., artificial intelligence, automation in all of its forms, hyper-scalable platforms, faster data transmission, quantum computing, blockchain, digital currencies and the metaverse) and/or other market forces may outpace our organization's ability to compete and/or manage the risk appropriately, without making significant changes to our business model

Ensuring data privacy and compliance with growing identity protection expectations and regulations may require alterations demanding significant resources to restructure how we collect, store, share and use data to run our business

Regulatory changes and scrutiny may heighten, noticeably affecting the way our processes are designed and our products or services are produced or delivered



M Macroeconomic Risk Issue S Strategic Risk Issue O Operational Risk Issue ■ 2032 ■ 2031 ■ 2030

About the Executive Perspectives on Top Risks Survey

We surveyed 1,304 board members and executives across a number of industries and from around the globe, asking them to assess the impact of 38 unique risks on their organization over the next 12 months and over the next decade. Our survey was conducted online in September and October 2022 to capture perspectives on the minds of executives as they peered into 2023 and 10 years out.

Respondents rated the impact of each risk on their organization using a 10-point scale, where 1 reflects "No Impact at All" and 10 reflects "Extensive Impact." For each of the 38 risks, we computed the average score reported by all respondents and rank-ordered the risks from highest to lowest impact. We also grouped risks based on their average into one of three classifications:

Read our *Executive Perspectives on Top Risks Survey* executive summary and full report at www.protiviti.com/toprisks or http://erm.ncsu.edu.

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