EXECUTIVE PERSPECTIVES ON TOP RISKS

for the Near- and Long-Term

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The financial services industry confronts a period of heightened risk

by Michael Thor

Boards of directors and senior executive teams across all industries are facing a complex web of uncertainties. These may generate both opportunities for strategic advantage and risks leading to unexpected disruption and performance shortfalls. The ability to anticipate and adapt to these risks and opportunities is key to maintaining an organization's value and supporting its growth objectives.

Our 13th annual **Executive Perspectives on Top Risks Survey** contains insights from 1,215 board members and C-suite executives around the world regarding their views on the top risks they see on the near- and long-term horizon. Specifically, our global respondent group provided their perspectives about the potential impact over the near term (two to three years ahead) and long term (over the next decade) of 32 risk issues across these three dimensions:

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

Commentary – Financial Services Industry

Consistent with past surveys, the results of the financial services industry (FSI) reflect a higher level of concern about the risk environment than the general population of survey respondents. What is noteworthy this year is that the deviation between the risk ratings of the general population and FSI is significantly higher than in the past.

There are several reasons that may explain why FSI companies would view the environment as riskier than companies in other sectors. These might include consideration of the effect of financial market volatility on the customer base and the related impact on credit risk; greater exposure to cyber risk given the industry's heavy reliance on technology and the ensuing operational challenges that may follow a cyber breach; and an intrusive and ever-changing regulatory environment.

A riskier business environment means added pressure on the financial services industry to monitor and adapt quickly to changing market conditions and, as necessary, pivot their strategies. This means the industry needs to place a premium on horizon scanning and scenario planning.

Horizon scanning has never been more vital to financial institutions' efforts to identify and proactively prepare for emerging risks and opportunities than in these dynamic and uncertain times.

Bernadine Reese, Managing Director, Protiviti London

On a positive note, however, the survey results suggest that financial services companies, like the population at large, are more confident in their resilience, agility and preparedness to deal with change. This is reflected in the survey by the declining concern with cultural issues which historically have impeded companies' ability to address and adapt to change. This newfound confidence likely comes from being battle-tested by the global pandemic and its resulting challenges, a growing number of cyber-attacks, the exponential pace of innovation, and an increasingly fraught geopolitical landscape.

Analysis of the top near-term risks

The top 10 risks for the financial services industry are concentrated in the operational and macroeconomic categories although concerns about regulatory change, uncertainty and scrutiny – a constant in FSI survey results – also ranks prominently. What becomes clear from analyzing the results, however, is how intertwined the top 10 risks are.

Operational risks dominate FSI's top risks

Operational risks account for six of FSI's top 10 near-term risks. Consistent with the population at large, cyber threats ranked second overall on FSI's list. The constant challenge of keeping pace with the ever-evolving cyber threat landscape is likely also a contributing factor for including other operational risks –

third party risk risks (#4), ensuring privacy and identity protection (#7), and emergence of new risks associated with artificial intelligence (#9)– as significant operational risks.

There is no denying the interconnectivity among these risks. Artificial intelligence, for example, presents myriad opportunities for the financial services industry, including enabling faster and more targeted threat detection, but it also allows cybercriminals the means to undertake more sophisticated, large-scale attacks against financial institutions, their third-party providers and their customers. Successfully navigating these interdependent risks requires a proactive approach to risk management, continuous investment in technology and talent, and a commitment to regulatory compliance and ethical practices, all contributing to a resilient organizational framework capable of thriving amid uncertainties.

The two other operational risks included in FSI's top 10 near-term risks are the ability to attract, retain and develop talent (#6) and operations and legacy systems unable to meet performance expectations (#8).

Both of these risks also impact the ability of the industry to exploit the benefits of artificial intelligence.

With the democratization of AI and its increased ease of adoption, we are seeing it act as a de-facto weapon when in the wrong hands. However, it can be an equally powerful defense mechanism. And we have seen it deployed in such capacity.

Constantine Boyadjiev, Managing Director, Protiviti New York

Macroeconomic risks feature prominently

Consistent with the population at large, FSI views economic conditions, including inflationary pressures, as the most significant near-term risk. Two other macroeconomic risks, changes in the interest rate environment (#3) and talent and labor availability (#10), are also top 10 risks for FSI.

The prominence of economic conditions, including inflationary pressures and changes in interest rates, as a top risk underscores the vulnerability of financial services to macroeconomic fluctuations. Globally, these economic conditions can vary significantly, with some regions experiencing rapid growth while others face economic slowdowns. Inflation affects interest rates, asset values and borrowing costs, impacting lending practices and investment strategies. Economic slowdowns or downturns can lead to increased loan defaults, reduced investment activity, and tighter credit conditions, which can significantly impact the profitability and operational efficiency of financial institutions.

The focus on labor talent reflects the industry's need for skilled professionals who can navigate the complex and dynamic environment of financial services. The emergence of AI and data-driven decision-making has added to the demand for specialty and competition for top talent is fierce. The ability to attract, develop, and retain skilled workers is crucial for driving growth and sustaining competitive advantages in a market where operational excellence and innovation are key.

In summary, the interconnectedness of global economic conditions and labor market dynamics creates dependencies for financial services firms. Successfully navigating these risks requires a robust understanding of both global economic trends and local market conditions, combined with an ability to adapt to technological advancements and shifts in labor market dynamics.

Regulatory Change, Uncertainty and Scrutiny

The risk of regulatory change, heightened regulatory scrutiny, and regulatory enforcement is a perennial concern for the financial services industry. A significant driver of this year's ranking (#5) is likely the high degree of uncertainty about the near term. Even in jurisdictions such as the US and U.K. where financial services companies may be anticipating a less aggressive regulatory environment as part of an effort to deregulate and promote competitiveness, the extent and pace at which changes will occur and the complexities that may be introduced for financial institutions operating in multiple jurisdictions make it difficult to evaluate the near-term regulatory environment.

Keeping pace with a rapidly evolving regulatory environment presents a significant challenge for financial institutions. Yet, it is essential to the success of an organization and demands continuous vigilance, flexibility, and investment in compliance capabilities.

Matthew Moore, Managing Director and Global Leader of Risk and Compliance, Protiviti Charlotte

Risk category	Top 10 near-term risk issues	Score*
M	**1.** Economic conditions, including inflationary pressures	3.65
O	**2.** Cyber threats	3.57
M	**3.** Change in current interest rate environment	3.52
O	**4.** Third-party risks	3.34
S	**5.** Heightened regulatory change, uncertainty and scrutiny	3.34
O	**6.** Ability to attract, develop and retain top talent, manage shifts in labor expectations, and address succession challenges	3.31

O	**7.** Ensuring privacy and compliance with growing privacy and identity protection risks and expectations	3.26
O	**8.** Operations and legacy IT infrastructure unable to meet performance expectations	3.22
O	**9.** Emergence of new risks from implementing artificial intelligence	3.21
M	**10.** Talent and labor availability	3.21

*Respondents were asked to rate 32 individual risks on a five-point Likert scale, where 1 reflects "No Impact at All" and 5 reflects "Extensive Impact." For each of the 32 risks, we computed the average score reported by all respondents and rank-ordered the risks from highest to lowest impact. Risks rated 3.11 or higher are deemed to be significant risks.

Outlook for the long-term

For the financial services industry, long-term risks mirror the short-term risks, with each of the top five near-term risks also identified as top five long-term risks. Given the enduring nature of these risks, it is not surprising that financial institutions would consider them continuing priorities.

The next decade for the financial services industry, fueled by fast-paced technological innovation, changing customer expectations, and evolving regulatory landscape, will be transformative. Successful organizations will need to adapt quickly and confidently to remain competitive and ensure their resilience and relevance in a rapidly changing market.

Carol Beaumier, Senior Managing Director, Protiviti Washington, D.C.

Economic conditions emerged as the key risk with economic conditions, including inflationary pressures, and changes in the interest rate environment topping the list of concerns 10 years out. Rounding out the top five long-term risks are cyber threats; heightened regulatory change; uncertainty and scrutiny; and the rapid speed of innovation.

Long-term risk outlook

Macroeconomic risk issues

Risk	Percentage
Economic conditions, including inflationary pressures	48%
Change in current interest rate environment	41%
Access to capital/liquidity	22%

Strategic risk issues

Risk	Percentage
Heightened regulatory change, uncertainty and scrutiny	37%
Rapid speed of disruptive innovations enabled by new and emerging technologies and/or other market forces	31%
Adoption of AI and other emerging technologies requiring new skills in short supply	30%

Operational risk issues

Risk	Percentage
Cyber threats	39%
Ability to attract, develop and retain top talent, manage shifts in labor expectations, and address succession challenges	27%
Third-party risks	26%

Note: Respondents were asked to identify the “top two” risks in each category (macroeconomic, strategic, operational) separately. That is, respondents identified six risks (two in each category) as “top two” risks. For each category, the three risk issues (including ties) receiving the most responses by percentage are shown in the charts above.

About the Author

Michael Thor is a Managing Director and leader of Protiviti's Financial Services industry in the Americas. He has over 26 years' experience in providing risk management and consulting services to organizations within financial services, including banking, insurance, and asset management.

About the Executive Perspectives on Top Risks Survey

We surveyed 1,215 board members and executives across a number of industries and from around the globe, asking them to assess the impact of 32 unique risks on their organization over the next two to three years and over the next decade, into 2035. Our survey was conducted online from mid-November 2024 through mid-December 2024. For the near-term outlook, each respondent was asked to rate 32 individual risks on a five-point Likert scale, where 1 reflects "No Impact at All" and 5 reflects "Extensive Impact." For each of the 32 risks, we computed the average score reported by all respondents and rank-ordered the risks from highest to lowest impact.

We also asked executives to share their perspectives about long-term risks (over the next 10 years – 2035) by selecting the top two risks from each of the three dimensions (macroeconomic, strategic and operational). For each of the 32 risks, we calculated the percentage of respondents who included that risk as one of their two top risks for each dimension.

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