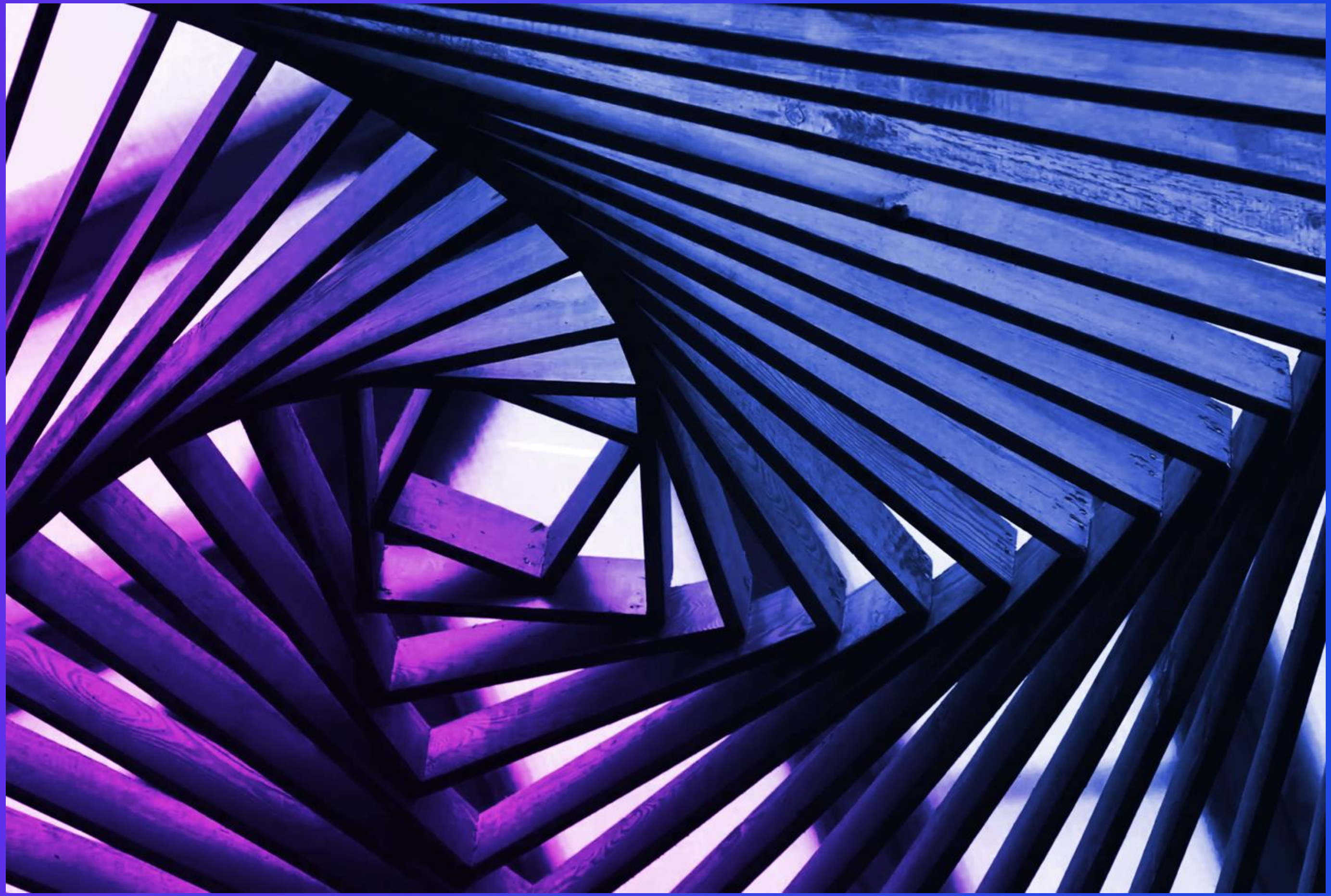
Managing harm and the impact on financial resilience



Risk and ICARA Benchmarking Survey 2022

Contents

Foreword

The impact of the IFPR on the financial resilience of investment management firms is varied, with significant changes in financial resource requirements being largely driven by firm's assessments in the ICARA.

With this the eighth edition of our annual Risk and ICARA Benchmarking Survey for investment management firms, the key change for firms is implementation of the Internal Capital Adequacy and Risk Assessment ("ICARA") under the new IFPR regime.

The impact of this on overall capital requirements is mixed, 52% of firms saw requirements increase compared to the previous year. Increases appear to be driven by internal firm assessments for harm from ongoing operations (Pillar 2 under the previous regime). However, some investment management firms have directly benefitted from the new regime through lower capital requirements driven by their assessments for credit and market risk.

Many survey participants are also subject to transitional capital guidance from the FCA, rolling over requirements under the previous regime. Assuming these firms are not provided new guidance in 2023, the coming year will result in significant change. Transitional guidance will expire by September 2023 at the latest and this could lead to substantial capital savings for these firms through lower capital requirements.

For all investment managers, the main driver of requirements continues to be operational risk. Under the IFPR, firms are required to assess the harm they could cause to clients, the markets and themselves. Our survey shows that the majority continued to use their operational risk assessments to assess harms through the ICARA and there were limited changes to these assessments.

While there may be capital benefits under the IFPR, we have also looked at the impact of new liquidity requirements under the regime. All firms are in scope of quantitative liquidity requirements for the first time. For many investment management firms, their ICARA liquidity assessment is driven by the liquidity required to wind-down the business in an orderly manner. This typically is significantly higher than regulatory minimum requirements. The FCA's focus on wind-down planning has been re-iterated through further guidance provided in 2022 and we expect all firms to develop their wind-down plans this year to embed this guidance.

The investment management industry is facing a new set of challenges and we expect firms to develop their approach to risk management in response to this

Our survey has also identified the key risk areas investment management firms are focussed on and how Risk functions are reacting to these. Top of the agenda is the impact of market turbulence, recessionary forces, ESG risks and regulatory change.

These risks will put direct pressure on revenues and profitability of some firms, while also changing their risk profiles. As a direct result, Risk functions are seeking additional skillsets, notably ESG, and seeking to embed technologies in their day-to-day operations. However, in the coming years we also expect firms to rebalance the three lines of defence and seek greater integration across Risk and Compliance as they react to a challenging business environment and a continuously evolving risk landscape.

Daniel Barry,

Partner,

KPMG in the UK

About the research

Our 2022 benchmarking approach

For our 2022 benchmarking survey, we have received responses from a broad range of firms across the investment management industry. Our respondents include large global asset managers through to smaller UK-based firms that provide a limited range of investment management services. All firms are prudentially regulated by the Financial Conduct Authority ("FCA") and subject to the Investment Firms Prudential Regime ("IFPR").

Participant background

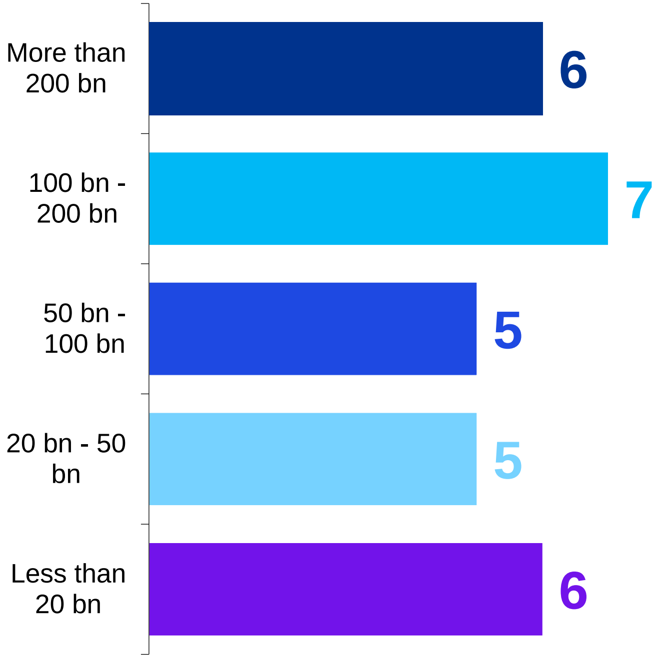
This year's survey is based on 29 participating firms of various scale as indicated by their assets under management, advice, or administration ("AUM/A")*. Six participants manage assets in excess of GBP 200 billion while another six have less than GBP 20 billion under management. From a regulatory perspective, half our participants are classified as P1 and P2 firms (who would usually be subject to a 1-3 year review cycle) whilst the other half are P3 firms, some of whom have never been through a regulatory review.

Our Survey Approach – the new regime

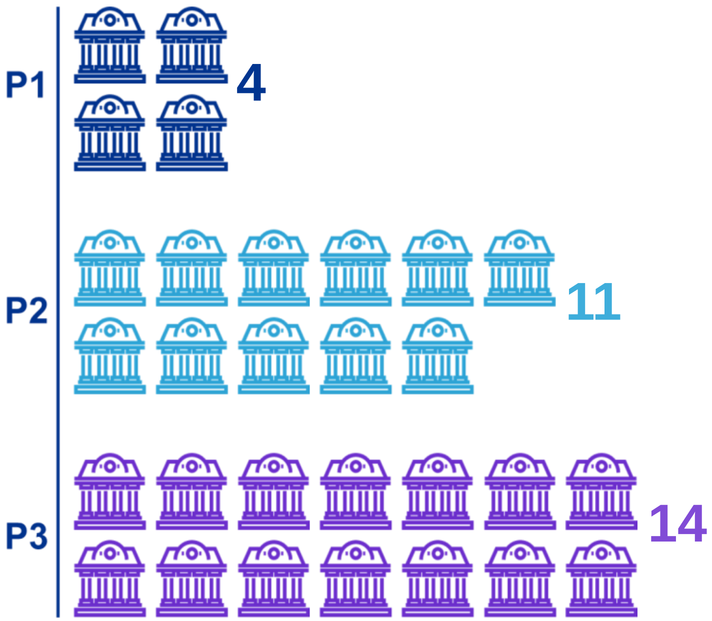
Our survey focuses on the IFPR, the new prudential regime for investment firms. This includes the industry's approach to new risk management and financial resource rules, the impact these have had and how firms are evolving their risk management arrangements in light of wider risk trends.

***** throughout the survey we use the term AUM/A to refer to the assets that each investment firm manages, administers or advises on. This includes both MiFID activities and regulated activities outside of MiFID (e.g. managing a UCITS) based on firm's own definitions of AUM/A.

Number of participating firms by AUM/A* (£)



Split of firms by prudential category



01

Financial resilience and the ICARA

Changes in capital requirements

The impact of the IFPR on overall capital requirements has been mixed, with capital requirements increasing for 52% of firms this year

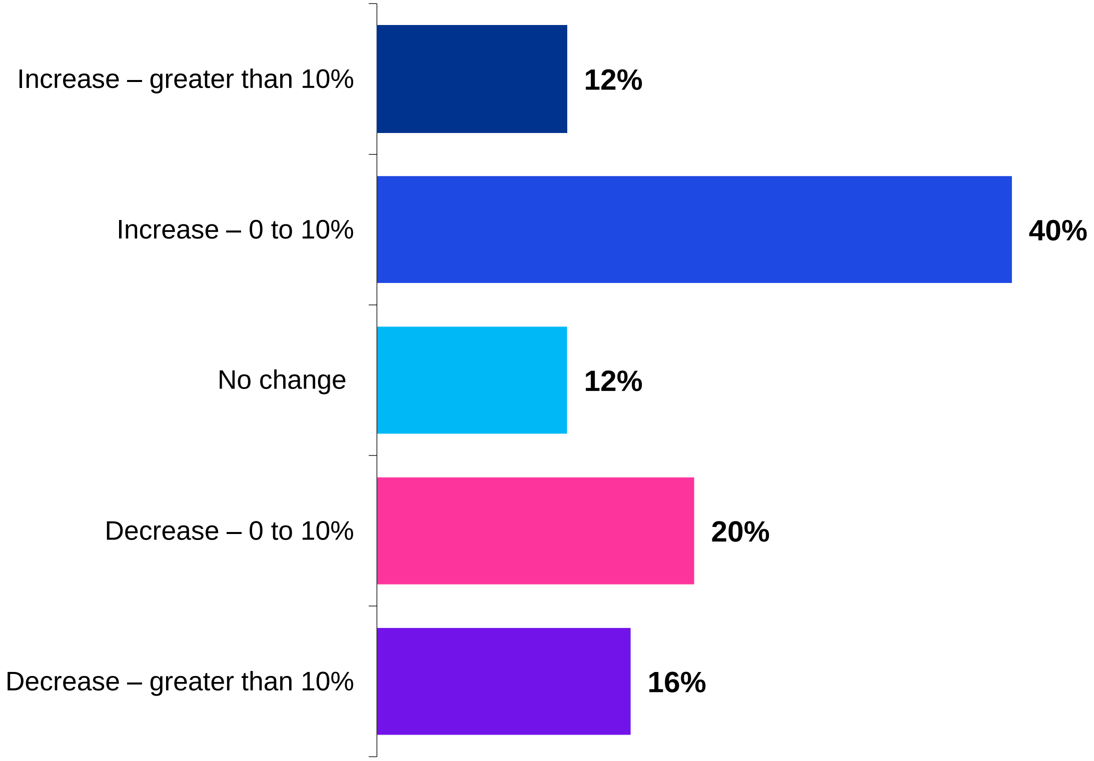
Trends in the data

- 52% of firms have seen an increase in their overall capital requirement (which can be driven by their internal assessments or through FCA guidance).
- Increases are typically driven by firm's self-assessments of capital, suggesting that growth in the business and risk profile is the driver of the majority of increases.
- For the 36% of firms which had reductions in requirements this year, the majority of these are subject to capital guidance by the FCA. However, more detailed analysis shows that removing FCA led requirements would have resulted in greater decreases (on average 15%) for these firms.

KPMG View

The differences in changes of overall capital requirements across participants is surprising given 2022 saw the introduction of the IFPR as a new regime. It likely also reflects that the new rules still require firms to hold capital based on historical FCA guidance and that own assessments of capital have increased with growth in the size of certain participants. Ultimately, the differences in these assessments have not resulted in significant changes for the majority of firms. However, where there are significant decreases (greater than 10%) our survey suggests this was a direct benefit of the IFPR removing requirements for credit and market risk.

Change in capital requirements for firms between 2021 and 2022



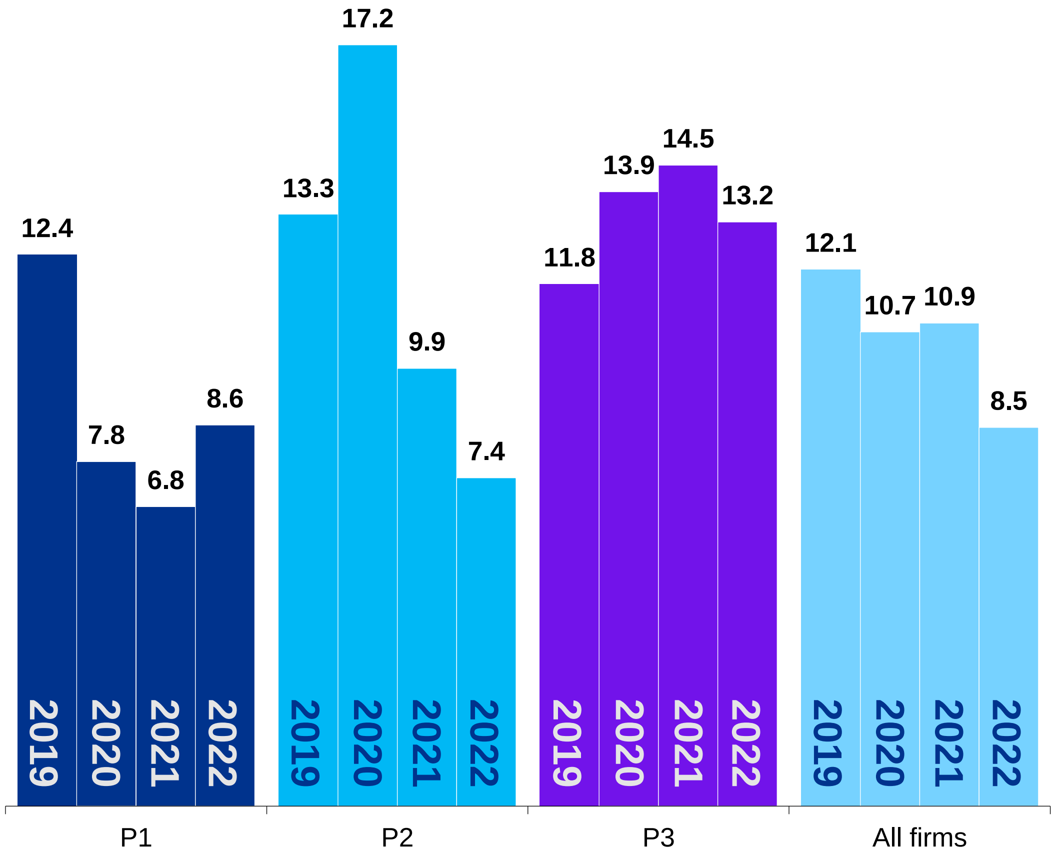
Overall capital requirements

Last year we highlighted how capital requirements for larger firms continued to decrease in proportion to their AUM/A. Now, it looks like these trends may have changed, with smaller firms being able to immediately benefit from lower requirements under the new regime

Trends in the data

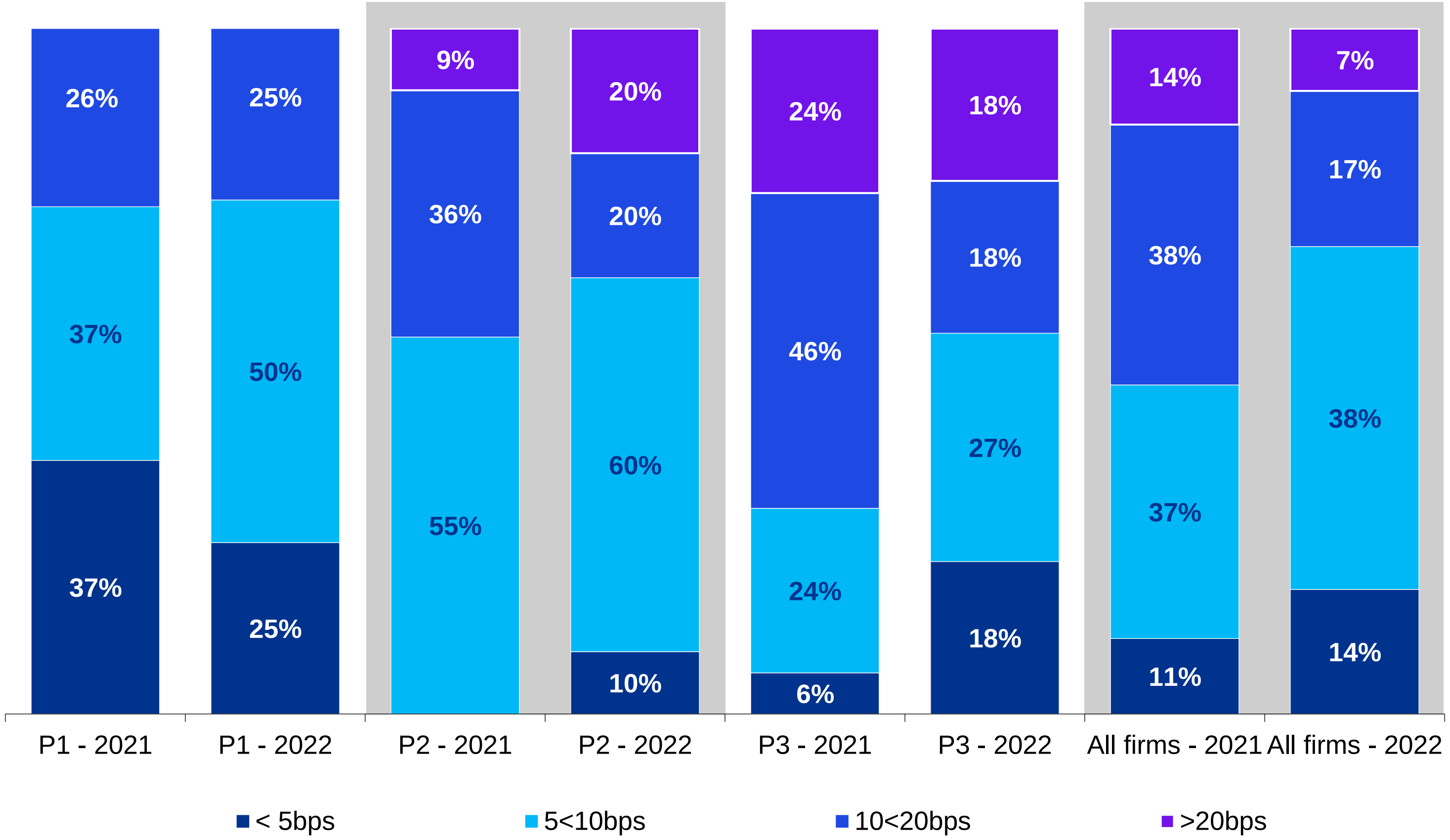
- The median capital requirement for P1 firms has increased to 8.6 bps of AUM/A (2021: 6.8). However, further analysis of these firms shows this increase is driven by changes in the survey participants as opposed to year-on-year increases. P2 firms continue to see proportionally lower capital requirements to 7.4 bps of AUM/A (2021: 9.9).
- 2022 sees the reversal of a historical trend where requirements for the smallest firms increased each year. The median requirement for these firms has fallen to 13.2 bps of AUM/A (2021: 14.5). While this is a reduction, smaller firms continue to hold proportionally more capital than larger ones.

Median overall capital requirement as a proportion of AUM/A (in basis points)



Overall capital requirements (continued)

Overall capital requirement as a proportion of AUM/A (in basis points) – percentage of firms in the following categories



KPMG View

We expected capital requirements for larger (P1/P2) firms to remain in line with levels from previous years as these firms are more likely to have requirements set by the FCA. For now, this continues to apply under the IFPR and this usually drives the capital requirement for the largest participants.

Smaller (P3) firms can immediately benefit from reductions in IFPR capital requirements for credit and market risk (which no longer apply to the majority of wealth and asset managers). Our survey shows that these firms have been able to take advantage of the new rules through reductions in requirements. This decrease will potentially enable firms to deploy surplus capital, either to be directly reinvested into the current business or to fuel future growth.

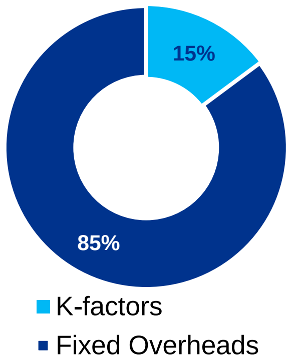
Minimum regulatory requirements and the impact of the K-factors

The K-factor requirement has a limited impact on capital

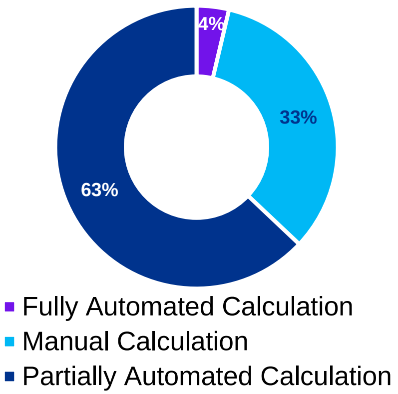
Trends in the data

- For the vast majority of firms (85%), the fixed overheads requirement (a capital requirement based on operating expenses) drives the regulatory minimum requirement (referred to as Pillar 1 under the previous regime).
- For the K-factor requirements, the most common K-factor participants are in scope of is K-AUM (96% of firms), followed by K-COH (58% of firms).
- The majority of firms have partially automated these calculations (63%). Few have implemented a fully automated solution.

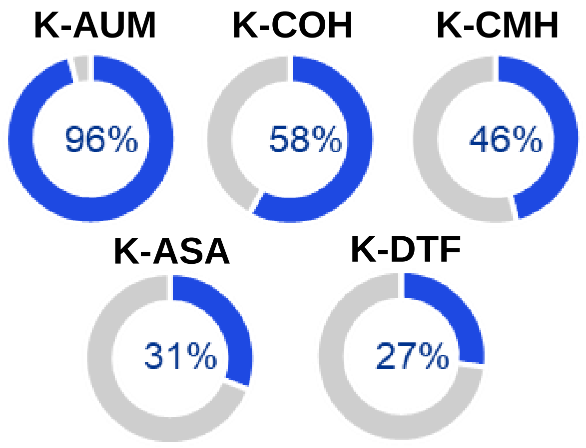
Percentage of firms by minimum capital requirement



Percentage of firms using the following approaches to calculation of the K-factors



Percentage of firms subject to each K-factor



KPMG View

A key change under the IFPR was the introduction of the K-factor requirements to accurately reflect the risks inherent to the activities of investment firms. In the original IFPR drafting (CP20/24) the FCA stated they expect K-factors to drive requirements for the 200 medium/large firms in scope of IFPR. Our survey shows that even for the largest firms, the K-factors are unlikely to drive overall requirements.

Many will find this surprising given the detailed data and rule requirements for these calculations. For asset and wealth managers, identifying how their management and advisory relationships should be treated when calculating K-AUM was a key concern during implementation. Other K-factors required large and complex data sets (such as transaction data). This resulted in manual calculations being performed on Day 1. However, we expect more firms to automate this in the future to reduce risk of error.

Transitioning to the IFPR and FCA capital guidance

Over half of firms (65%) are subject to transitional FCA capital guidance issued under the previous regime

Trends in the data

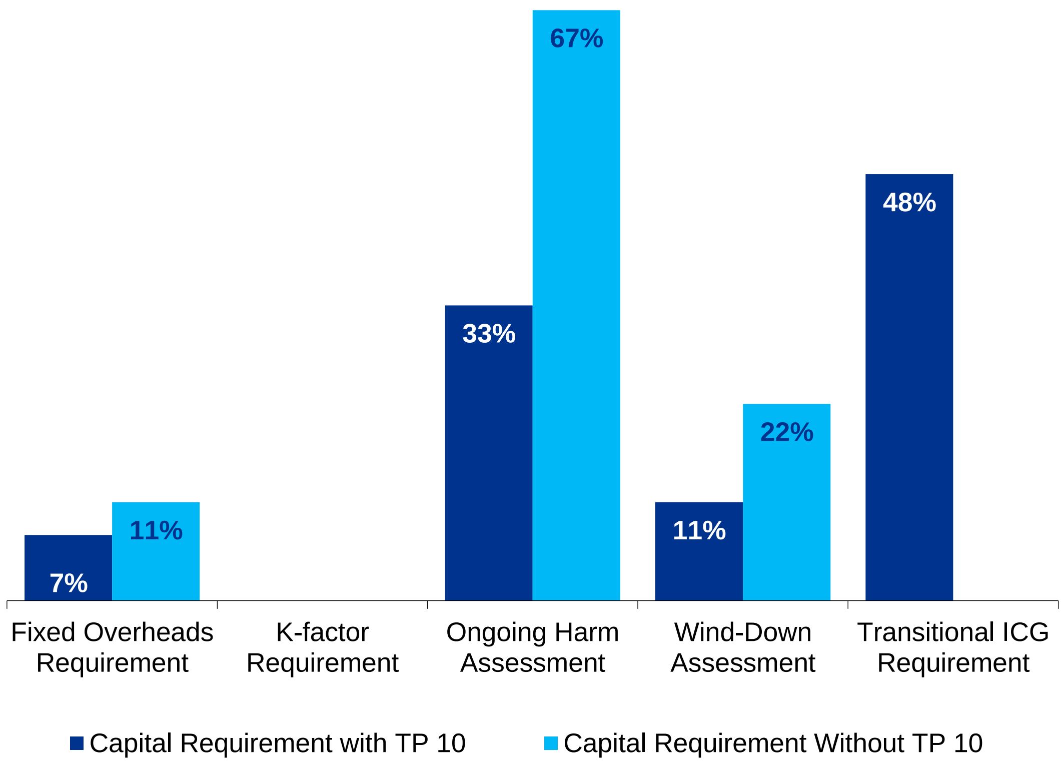
- For 48% of firms in the survey their overall capital requirement is driven by the FCA's transitional capital guidance. This requirement set under the previous regime will no longer apply from September 2023 onwards.
- Removing FCA set capital guidance would decrease capital requirements for these firms, with a median decrease in capital requirements of £30.5m for these firms.
- This would result in the ongoing harm assessment (referred to as the Pillar 2 assessment in the previous regime) driving the overall capital requirement for 67% of firms. For the remaining firms the wind-down requirement (22%) and fixed overheads requirement (11%) would drive the requirement.

KPMG View

While the FCA has already started supervisory reviews under the new IFPR regime, in our view these are unlikely to be completed for all firms subject to historical capital guidance before this expires in September 2023. Therefore, firms could see significant capital reductions once their IFPR transition completes.

This does, however, result in greater reliance on the quality and robustness of internal assessments performed through the ICARA process. The IFPR introduced new requirements for the ICARA, notably that firms must hold capital for the harms they can cause and to complete a wind-down in an orderly manner. The FCA is likely to focus on these new requirements in their supervisory reviews under the new regime, particularly given the range of guidance on both of these topics issued in recent years.

Percentage of firms surveyed split by basis of capital requirement – before and after TP 10 expires



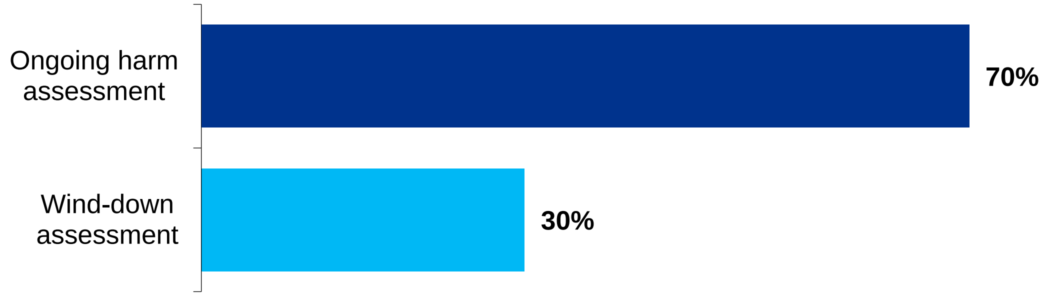
Own assessments of capital – ongoing harms

The IFPR introduces a ‘harms-based’ assessment of capital required for ongoing harms. For 70% of firms this drives their internal assessment of capital requirements

Trends in the data

- The harms assessment has replaced the Pillar 2 approach required in the previous regime. This is a shift from a risk-based assessment of capital requirements to a new approach which requires firms to identify harm to clients, markets and themselves. Our survey shows that the harm assessment drives the majority of internal assessments of capital.
- All firms have taken action to embed a ‘harms-based’ process within their risk management frameworks. 72% of firms have mapped each of the “three harms” to individual risks, 52% have mapped the “three harms” to their risk taxonomy and only one has implemented a new risk taxonomy based on the “three harms”.
- When we consider how firms are allocating capital to risks and harms, unsurprisingly investment managers are heavily weighted towards operational risk, making up a median 83% of the harm assessment.
- Despite the removal of credit and market risk requirements from the previous regime, 73% of firms continue to hold capital for harms arising from credit risk and 81% for harms from market risk.

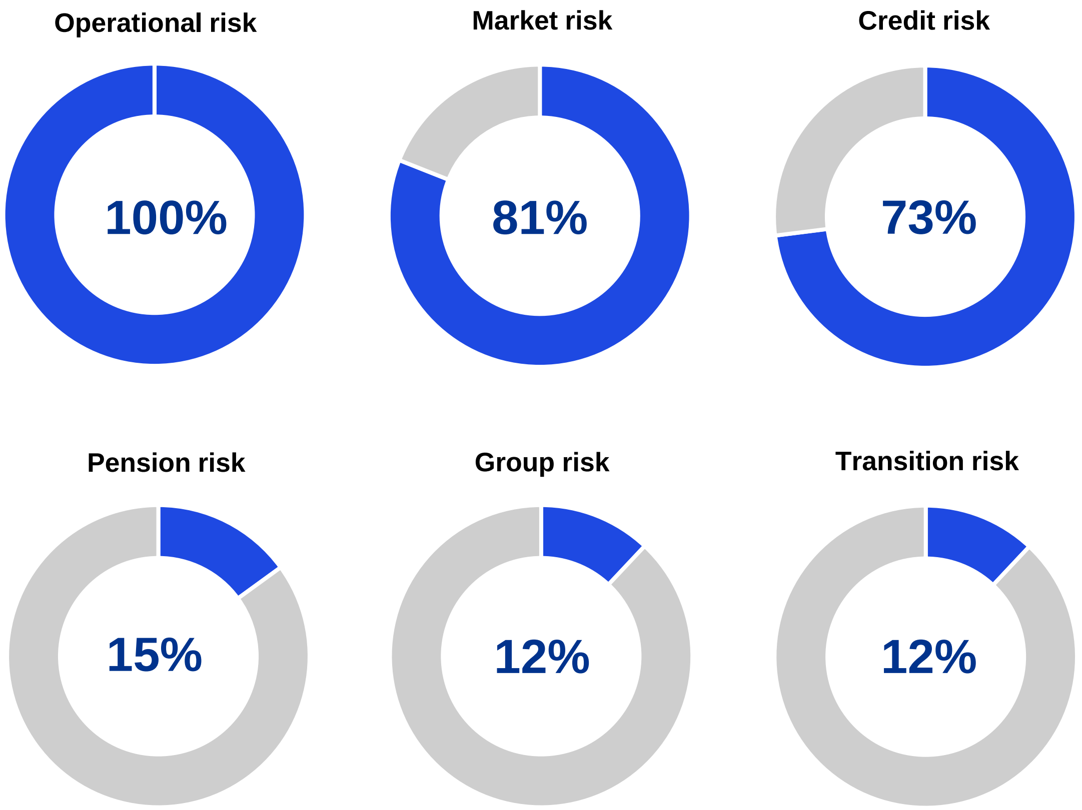
ICARA assessment: percentage of firms whose overall capital requirement is based on the following assessments



Harm assessments: median percentage of capital allocated to risk types as part of the harm assessment

Own assessments of capital – ongoing harms (continued)

Percentage of firms allocating capital to each types as part of the harm assessment



KPMG View

Under the ICARA process, our expectation was that assessments of capital requirements for ongoing harms would drive requirements for most firms. This is borne out in the survey and shows that the ICARA represents an evolution, as opposed to a whole change, in these assessments.

Embedding the management of harms within risk frameworks has been an area of challenge for all firms. Firms have adopted a tactical approach of demonstrating that their current framework is fit-for-purpose in managing harms. With broader regulatory initiatives also being ‘harms-based’ (Consumer Duty, Operational Resilience), in the future we expect firms to implement more strategic changes to risk frameworks to embed these concepts.

Operational risk leading harm assessments reflects that key risks for investment managers are predominantly driven by the harm they can cause to clients and themselves through this risk.

A key benefit of the IFPR is that credit and market risk rules no longer apply for most investment managers. Some firms no longer hold capital for these risks as a result. While this is no longer a requirement, in our view, the key challenge in the future will be to demonstrate that assessments of these risks are robust and appropriate. Particularly where potential regulatory scrutiny could occur in the event of significant changes in requirements between regimes. Firms holding capital for this risk may be adopting a cautious approach and can afford to do so given the size of these requirements relative to operational risk.

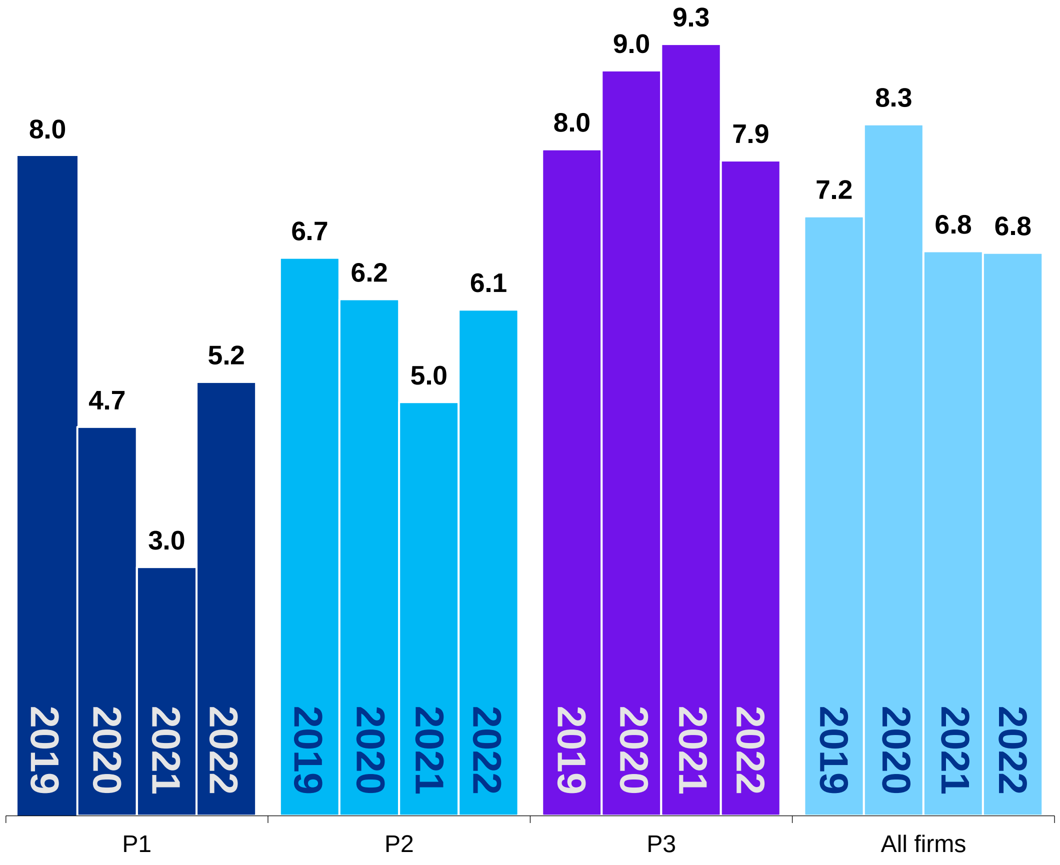
Focusing on harms from operational risks

Operational risk continues to be the most significant risk for investment firms in our survey

Trends in the data

- The median amount of capital allocated to operational risk as a proportion of AUM/A of 6.8 bps is unchanged from last year (2021: 6.8 bps).
- The median operational risk capital requirement for P1 firms has increased to 5.2 bps of AUM/A (2021: 3 bps). This increase is driven by changes in the survey participants as opposed to year-on-year increases.
- The reversal of a historical trend of the smallest firms increasing overall capital requirements year-on-year can also be seen when we focus on operational risk. The median requirement for firms in this prudential category as a proportion of AUM is 7.90 bps of AUM/A (2021: 9.31).

Median operational risk capital held as a proportion of AUM/A (in basis points)



Focusing on harms from operational risks

There continues to be significant variation across firms in terms of amount of capital held for operational risk and their approaches to this assessment

Trends in the data

- 48% of firms use statistical models to assess operational risk (2021: 56%)
- Firms using statistical models typically hold proportionally less operational risk capital (on average - 6.6 bps) then those using a simple approach (8.2 bps)
- Large firms are more likely to use statistical models, to apply diversification benefits and to use insurance mitigation.

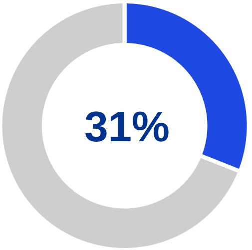
KPMG View

We expected operational risk to continue to be the most material risk for wealth and asset management firms under IFPR. Under the previous regime, all firms developed internal methodologies to assess this risk, and will have been able to leverage these for the new regime. Therefore, the amount of capital firms holding for this risk remaining broadly consistent year-on-year reflects that many were confident in their existing methodologies. Indeed, the median number and type of operational risk scenarios used by firms staying the same year-on-year suggests most firms have not identified any new 'harm' scenarios through the ICARA.

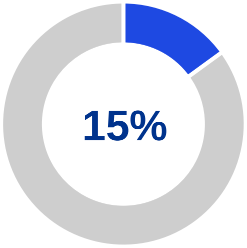
Differences between operational risk assessments of firms that use statistical models and those that adopt a simple approach are usually driven by two factors. Firstly, larger firms are more likely to use statistical models and these firms may benefit from economies of scale. Secondly using a statistical model usually includes firms applying diversification (i.e. assuming that not all risk scenarios occur at the same time) to operational assessments, lowering the requirement.

The median number of operational risk scenarios developed across all firms by Basel category is consistent year-on-year

Median operational risk capital haircut applied due to operational risk diversification



Median operational risk capital haircut applied due to insurance mitigation



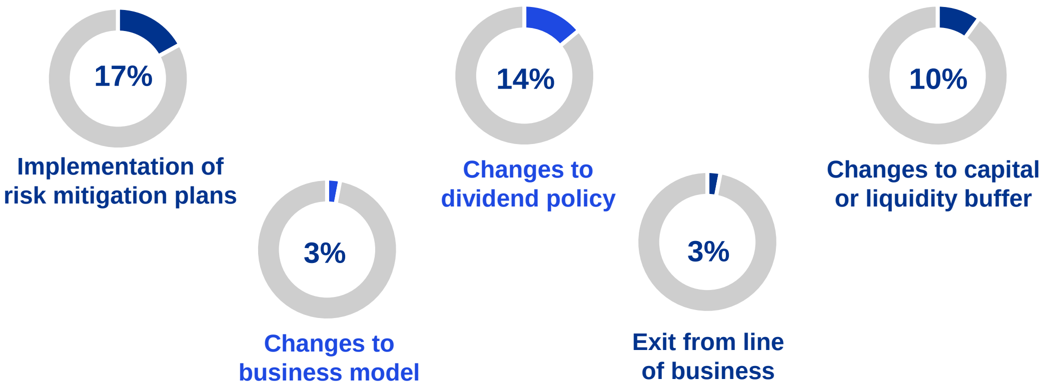
Business plan stress testing

Use of stress testing continues to be an area of challenge for all firms

Trends in the data

- 82% of firms conducted a stress test which resulted in them making a loss. Half modelled a stress that led a loss both before and after management actions.
- The most common action (17% of firms) taken due to stress testing is implementation of risk mitigation plans. Only 10% made changes to the capital or liquidity buffer held
- Almost all firms surveyed perform a reverse stress test, with 50% of firms considering three or more different key risks of failure within their reverse stress testing. 69% of firms included risks where the firm stops being profitable in their analysis.

Actions firms have taken as a result of capital stress testing



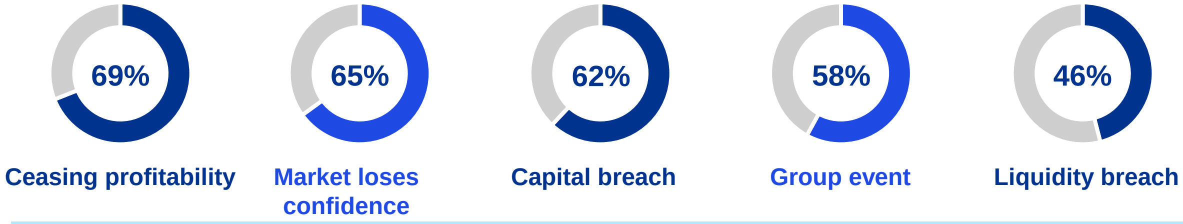
Median number of business plan stress tests performed by scenario type

3 — Idiosyncratic (firm specific)

1 — Macro-economic (e.g. market downturn)

1 — Combined

Types of risks of failure used in reverse stress testing



KPMG View

Use of stress testing can be an area of challenge for some firms who see it as a regulatory exercise. However, where firms embed stress testing in their capital planning and risk management process this can have significant benefits. Using stress tests to inform financial planning supports risk-based decision making, capital planning and the calibration of effective risk appetite measures.

By their nature reverse stress tests are expected to be extreme scenarios. Identifying these can often feel like an artificial process as the key risks to a business are unlikely to change year on year. The focus of many firms on profitability, market confidence and meeting capital requirements demonstrates that many investment managers face a core set of business risks. In our experience where firms are able to use reverse stress tests to inform and prioritise their strategic risk mitigation activities, this enables them to derive value from the assessment.

Overall liquidity requirements

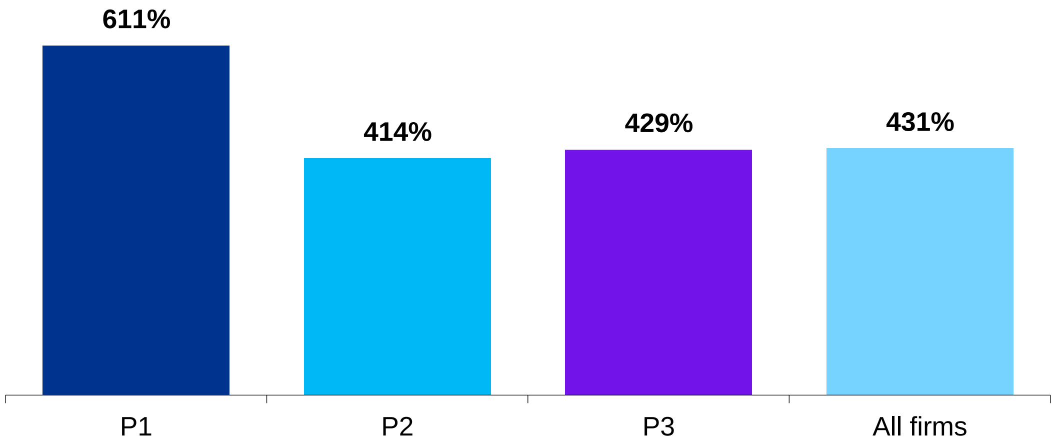
For the majority of firms, liquidity requirements under IFPR are driven by wind-down planning

Trends in the data

- 61% of firms surveyed have a liquidity requirement based on their assessment of wind-down liquidity. For the remaining firms, 39% have based the assessment on liquidity for ongoing operations.
- On a median basis, the wind-down assessment performed by firms is 15% higher than their ongoing operations assessment.
- As a proportion of the regulatory minimum requirement, large firms tend to have significantly higher requirements with all P1 firms surveyed having liquidity requirements greater than 500% of the BLAR.
- The vast majority of firms have self-assessed liquidity requirements significantly higher than the regulatory minimum for both ongoing operations and wind-down.

ICARA assessment: percentage of firms whose overall liquidity requirement is based on the following assessments

Median liquidity requirement against basic liquid assets requirement



KPMG View

Under the IFPR a firm's assessment of wind-down costs and ongoing liquidity needs is required. Given how significant these risks can be compared to the regulatory minimum, it is unsurprising that many firm assessments are higher.

Unlike for capital, liquidity requirements are typically driven by wind-down for most firms. This reflects that liquidity becomes a key risk area of investment managers in a wind-down scenario due the impact operating costs can have.

While ongoing operations is typically a smaller requirement, this does set requirements for some firms. We expect regulatory focus on these assessments under the new regime. Particularly on liquidity stress testing and how firms have used this in the ICARA process.

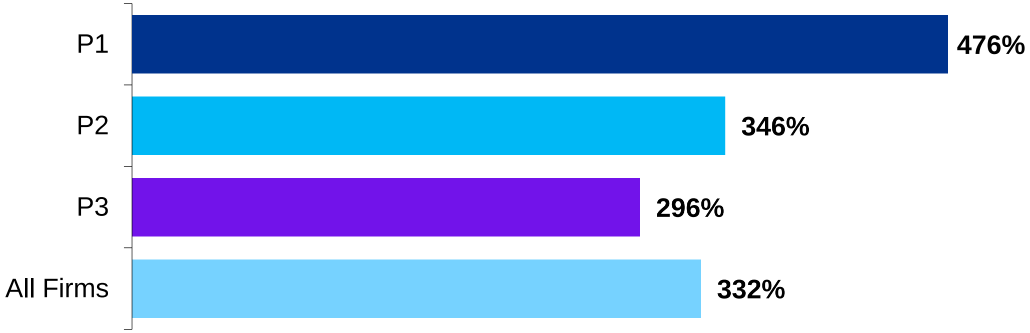
Own assessments of liquidity – ongoing harms

Firms are using liquidity stress testing to identify requirements for ongoing harms

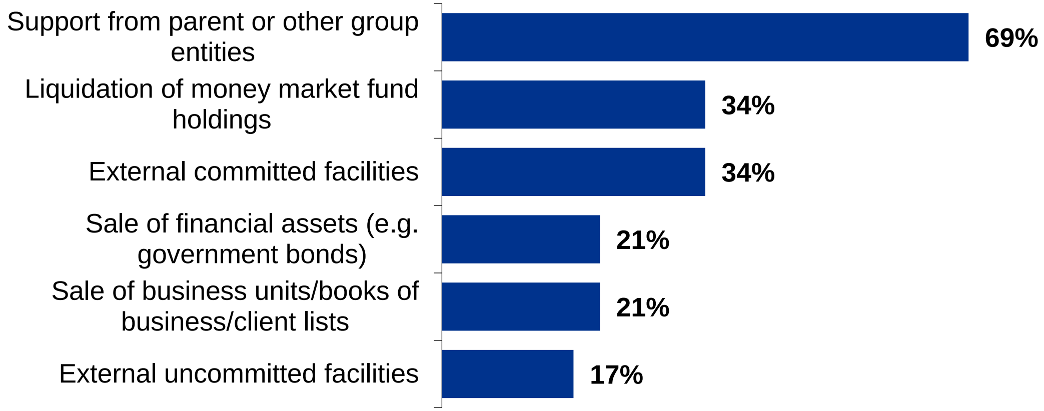
Trends in the data

- Under the IFPR all investment firms are required to perform assessments of liquidity requirements as part of the ICARA process. For requirements from ongoing harms, this should cover stressed events a firm could be exposed to. The majority of firms in the survey perform liquidity specific stress testing.
- 83% of firms surveyed performed liquidity specific stress testing, with these firms each performing a median of 3 stresses.
- 70% of firms reported considering liquidity stresses over at least a 3 month time horizon, with many firms considering liquidity stresses over the same time horizon as their capital stresses

Median ongoing operations liquidity requirement as a proportion of the Basic Liquid Assets Requirement



Liquidity specific recovery actions: percentage of firms including the following action types



KPMG View

All firms are expected to perform liquidity stress testing under IFPR. While the majority of firms in the survey have implemented this, there is FCA guidance on the types of risks firms should consider and we expect all to evidence how they have considered these risks.

For many firms this results in a wider range of liquidity stresses. However, the severity and nature of these scenarios is a subjective area and often where we see varied approaches. Therefore, demonstrating challenge and review of this process is crucial.

Use of recovery actions in liquidity stresses can lower overall liquidity requirements. Where they are used firms will need to ensure this is credible and that they can justify this in a period of stress.

Wind-down approaches and assumptions

Firms adopt a wide variety of approaches to wind-down planning and key assumptions used

Trends in the data

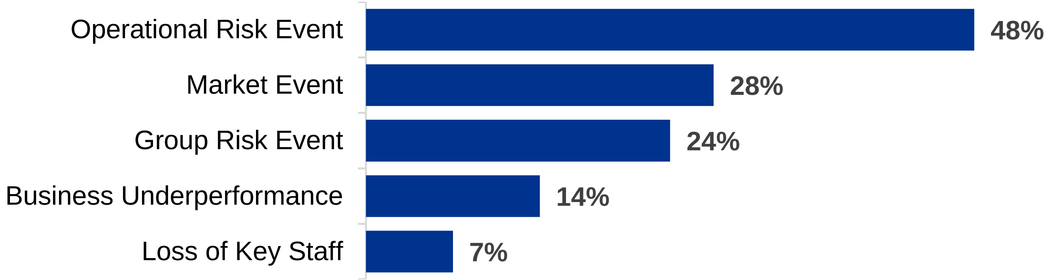
- 57% of firms assume a transfer or sale of a book of business during wind-down.
- 48% of firms surveyed conduct a wind-down scenario that is at least partly based on a firm-specific operational risk event.
- 72% of firms surveyed plan to offer retention bonuses to key staff during wind-down. 40% of firms reported retention bonuses greater than 50% of salary, with some firms offering double or even triple an employee’s salary as a retention bonus.

KPMG View

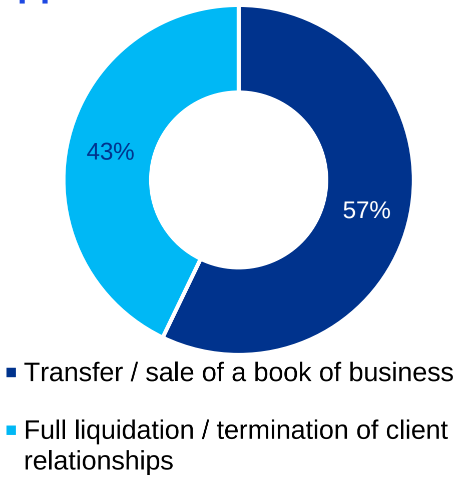
In recent years the FCA has issued several publications on wind-down planning. Under the IFPR, all firms are required to identify the steps and financial resources to ensure an orderly wind-down of their business. As a result of this focus, we have observed significant effort by firms to develop detailed wind-down plans.

While our survey shows the scenarios, approaches and key assumptions can vary, in our view there are two areas we think firms should focus on. The first is demonstrating that the wind-down plan contains enough detail to meet regulatory guidance and be operable. Secondly, firms should ensure financial resource assessments meet both the IFPR rules and FCA guidance.

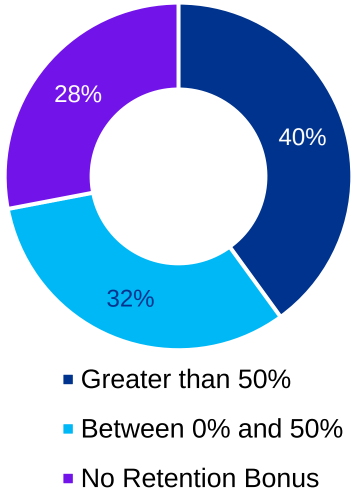
Proportion of firms including the following material risks in their main wind-down scenario



Percentage of firms by approach to wind-down



Percentage of firms by retention bonus assumption



Capital and liquidity requirements for wind-down

Compared to ongoing costs, the wind-down capital requirements for larger firms are proportionally higher

Trends in the data

- The IFPR introduced a formal requirement for firms to calculate the capital and liquidity required to wind-down the business. When we compare the costs of wind-down reported by surveyed firms against the fixed overheads requirement we see that for larger and more complex firms, the median calculated cost of wind-down is 183% of the FOR. For smaller firms, this figure is 136%.

Median wind-down capital requirement as a proportion of the Fixed Overheads Requirement

KPMG View

Large firms are more likely to undertake a wide-range of activities and potentially mange more complex products. Therefore, the wind-down process is likely to be longer and cause additional expenses due to the added complexities of winding down. As a result, this likely drives higher costs identified by these firms.

Wind-down liquidity requirements are significantly larger than the rules-based regulatory minimum

Trends in the data

- Compared to the regulatory minimum (the basic liquid asset requirement), wind-down liquidity requirements for all firms are significantly higher (a median increase of 347%).
- 20% of all firms have assessed their wind-down liquidity requirement to be the same as their wind-down capital requirement.

Median wind-down liquidity requirement as a proportion of the Basic Liquid Assets Requirement

KPMG View

Understanding the liquidity requirements and potential cashflow mismatches that could occur can be a subjective exercise. However, significantly higher self-assessments for investment management firms reflects that wind-down is often driven by cash outflows for operating expenses. Therefore, the cost of wind-down is higher than a month of operating expenses (the regulatory requirement).

02

Risk management themes

Risk themes for wealth and asset management firms

We asked firms to identify the most impactful areas of risk in the next three years – nearly all firms identified market turbulence, regulatory change, and ESG

Trends in the data

- A significant majority of firms (over 70%) expect market turbulence and recessionary forces to have a high impact on their business model over the next three years.
- Regulatory change and ESG/Climate risks are also high on the risk agenda, with over 50% of firms expecting these to have a high impact.
- Notably, external factors are deemed to have the highest impact on firms with changes in business models or the workforce viewed as having a less significant risk impact.

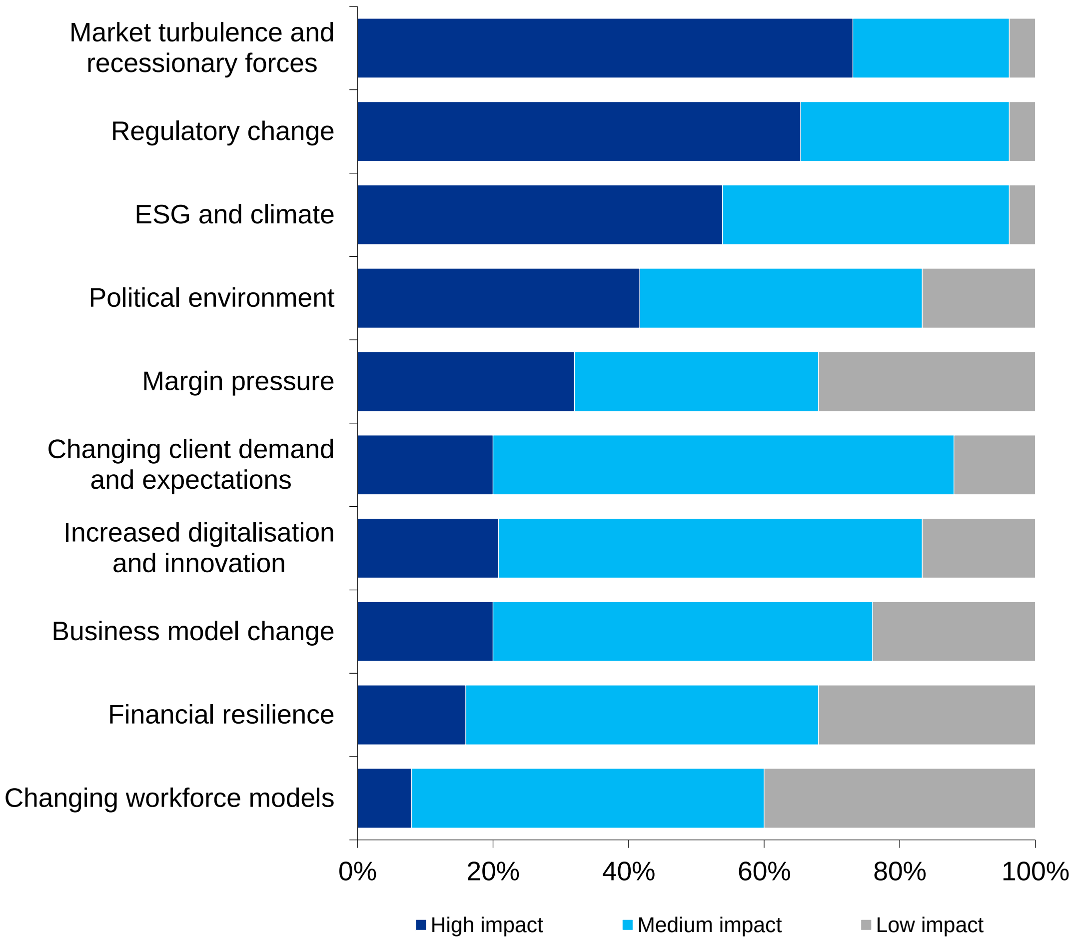
KPMG View

Given falls in global markets and volatility during 2022, many firms have this high on their risk agenda. A challenging economic outlook characterised by low growth, high inflation and a general contractionary environment will have an impact on revenue and profitability of investment managers. This may also impact risk profiles due to the financial and operational stresses this can cause.

Alongside these market events, the industry is going through fast-paced regulatory changes (including Consumer Duty in the UK and a wide range of ESG regulations globally). Leading firms will demonstrate that Consumer Duty has enabled a customer centric business model and may act as a differentiator in winning and retaining clients.

ESG and climate related risks can have a significant impact on wealth and asset managers across the risk landscape (ranging from product development through to reputational risk). The breadth of ESG change and emergence of regulatory interventions where firms get this wrong have no doubt brought this high on the agenda. Managing the risks associated with this will continue to require significant resource and effort.

Most impactful areas of risk over the next 3 years



Digitalisation and disruptive technologies

Firms are most concerned about the risk impact digitalisation and disruptive technologies will have on cyber security

Trends in the data

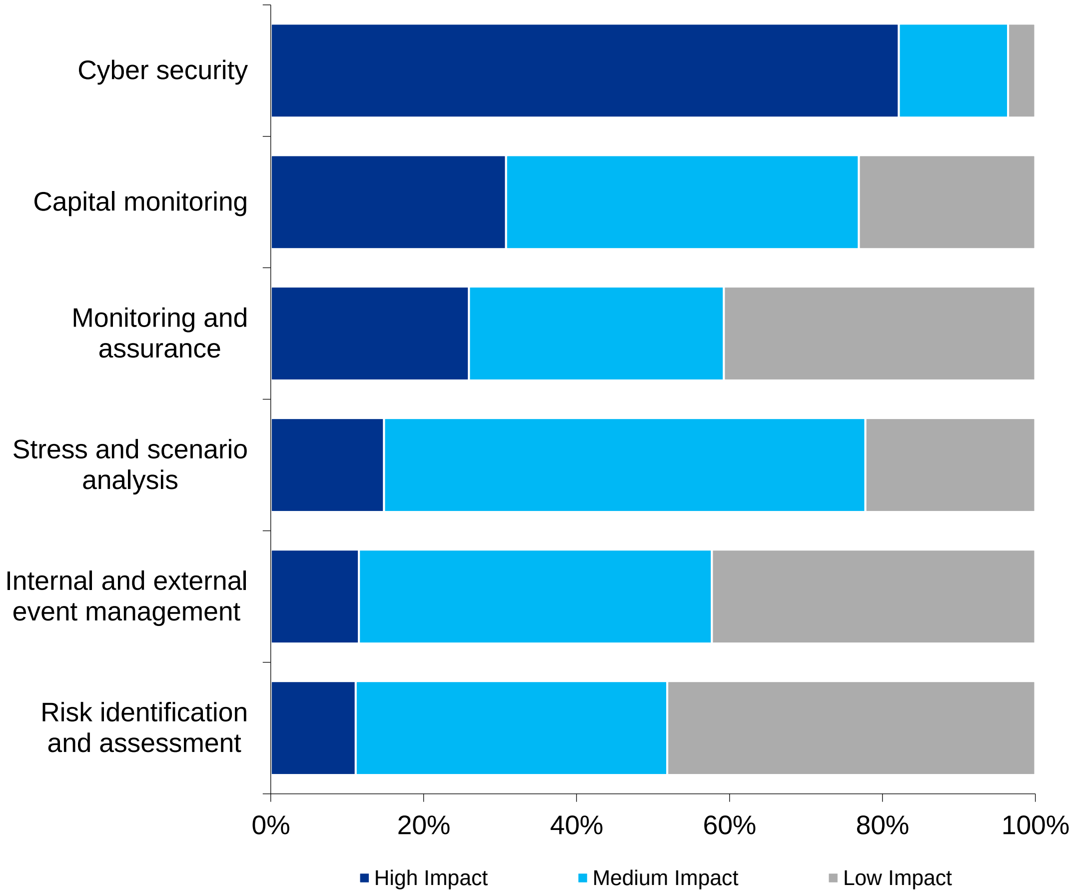
- With over 80% of firms surveyed highlighting the high impact on cyber security risks presented by digitalisation and disruptive technologies it is by far the most prevalent area according to our survey participants.
- Many firms do not expect remaining risk management areas to be significantly impacted by digitalisation and disruptive technologies.

KPMG View

Digitalisation and the use of disruptive technologies is most likely to impact the cyber security risk of all firms as they go through significant transformation programmes and continue to digitise their business models to meet client expectations. As the sector continues to innovate and digitalise more broadly, this brings into focus the high correlation between cyber attacks and geopolitical risk. Risk functions need to make sure they are pro-active in identifying these risks and have the skillsets to respond to them appropriately.

It is notable that many firms do not expect their core risk management processes (monitoring and assurance, scenario analysis and event management) to be significantly impacted by digitalisation and technology change. In a recessionary environment and with other emerging challenges (e.g. regulatory change, ESG/climate risks), this presents an opportunity for Risk functions to use new technologies to operate in a more efficient and targeted manner.

Impact of digitalisation and disruptive technologies



Risk function skillsets

We asked firms to identify in demand skillsets in their Risk functions – ESG and sustainability skills are high in demand

Trends in the data

- 96% of firms surveyed stated that ESG would be a high or medium impact area for their business in the coming years, with that in mind it is unsurprising that firms have identified ESG and Sustainability as the most in demand skillset within their Risk management functions. With nearly 80% of firms classing this as a much needed skillset within their Risk functions.
- We also observed earlier that firms were concerned by the potential impact of market turbulence and recessionary forces along with political uncertainty, which is underlined by the recent turmoil within the UK Gilt markets and LDI-based funds. 71% of firms highlighted a need for enhancing their resilience capabilities.

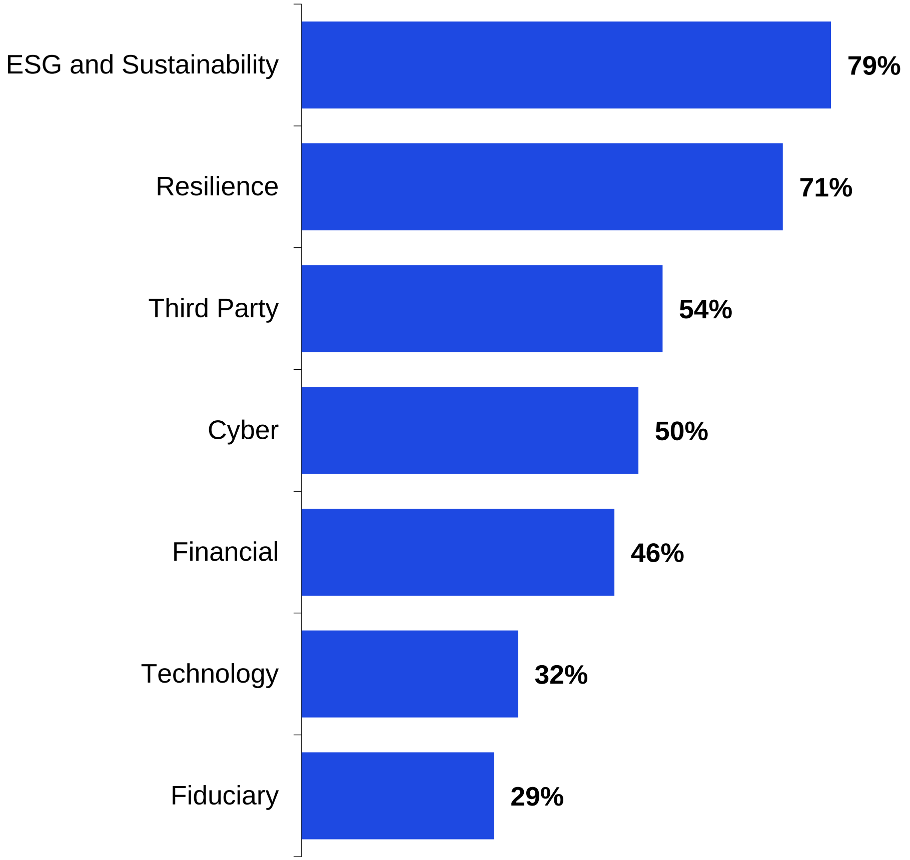
KPMG View

To react to the emerging risk landscape, firms are hiring and developing capabilities areas of greatest risk. ESG and sustainability skillsets are in high demand across the industry and, in our view, this reflects the wide-ranging impact this risk can have, the need to have a holistic understanding of this risk across all components of ESG and to manage both corporate and fiduciary ESG risks in the second line. As a result, Risk functions must have the technical expertise to effectively oversee and challenge the business.

Resilience, third party risk and cyber security skillsets reflect the high risk profile this has for the majority of firms in a digital world and the wave of regulatory change in this area. This often requires distinct skills, with a general focus at all firms on IT risk and financial crime.

In our view, the challenge of getting the risk skills and capabilities in the Risk function will continue. While, a recessionary environment may cause firms to reassess headcount, the risk landscape will continue to evolve at a pace which requires them to have specialist skillsets and knowledge to keep up.

Most in demand skillsets within Risk management functions



Technology use by Risk functions

The majority of firms deploy technologies within their Risk functions. However, with much talk on how Artificial Intelligence could be used within financial services firms, only 5% use this technology for risk management.

Trends in the data

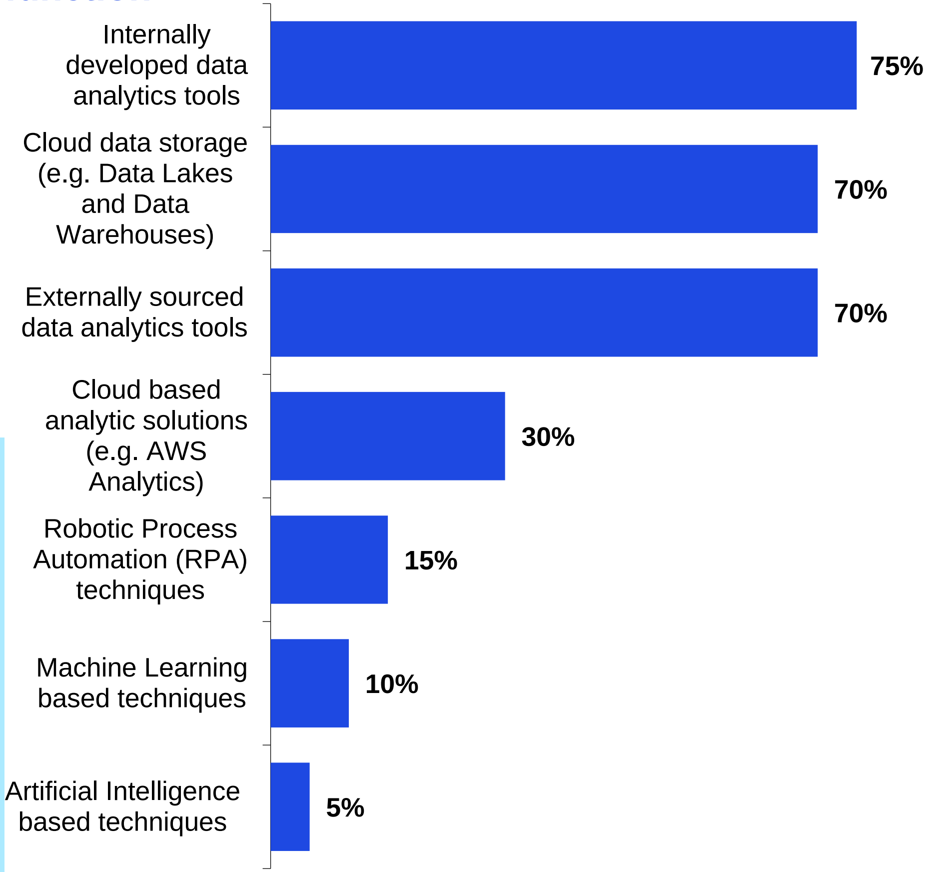
- Risk functions are deploying technologies as part of their operating models, with the focus being on internally developed data analytics (used by 75% of firms), externally developed tools (used by 70% of firms) and use of cloud data storage (70% of firms).
- However, use of other analytic solutions is limited. 30% of firms reported using cloud based analytics and there is limited adoption of robotic process automation, machine learning, and artificial intelligence, with only 19% of firms using at least one of these.
- One third of firms state their governance, risk and compliance (”GRC”) system is not fit for purpose.

KPMG View

In our experience, leading technology in Risk functions is typically used to address specific risk areas. Tools such as regulatory horizon scanning, client outcome testing, trade surveillance and portfolio risk management (e.g. for ESG analytics) have all been successfully deployed in investment firms to address the risks presented by specific areas.

The use of GRC tools to help manage all aspects of the risk management cycle is common place across the Wealth and Asset Management sector. However, the fact that a third of the respondents say their system is not fit for purpose may point to a lack of investment into the application for a significant period of time. We feel there is more that can be done to enhance GRC capabilities, and related technologies, so they can more meaningfully contribute to the ICARA process, whether that be through improved analytics or data groupings to support more insightful stress and scenario testing.

Technologies currently deployed within the Risk function



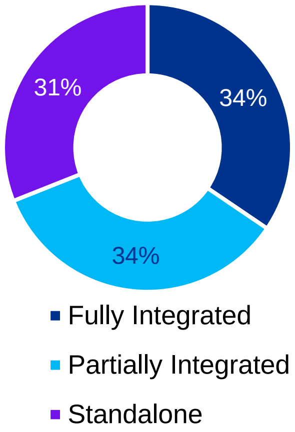
Design and structure of Risk functions

The majority of firms do not have a first line Risk Function, with these responsibilities lying solely with risk owners in the first line

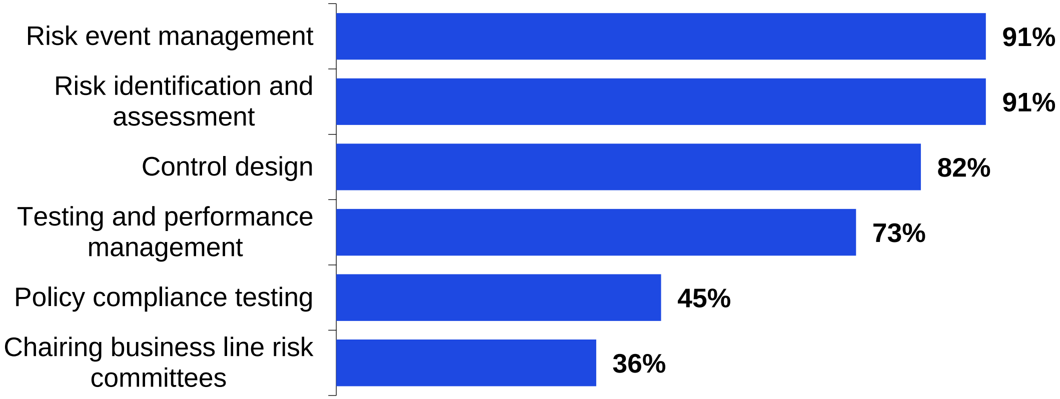
Trends in the data

- While a majority of firms do not have a formal first line Risk function (62%), 55% do have dedicated Risk resources within the first line to support risk owners and 39% have a ‘1.5 line of defence’. Even less reported using risk champions across the business that report into the second line, with 11% taking this approach.
- Where firms do have a formal first line Risk function, their responsibilities predominantly focus on event management, identification and assessment and control design.

Integration of second line of Defence



Activities performed by Risk functions within the first line



KPMG View

Across the three lines of defence, investment management firms have always adopted different approaches to organisational design and functional responsibilities. Rebalancing the lines of defence is driven by increasing accountability in the first line is driven by both a more mature SMCR environment (with more ownership of risks, controls and outcomes) and a focus on operational efficiencies. Firms who support this rebalancing through dedicated resource in the first line will likely see greater consistency in approaches to risk management.

In our experience integration of the second line of Defence (i.e. the Risk and Compliance functions) has worked best where those activities with common features (typically Risk and Compliance operations, framework design, data management, event/breach management and reporting) are together in a single hub. Many firms have also seen the benefits of nearshoring/offshoring in these functions.

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