

CANADIAN FINANCIAL SERVICES RISK OUTLOOK SURVEY 2023

A GLOBAL RISK INSTITUTE SURVEY

FEBRUARY 2023



The Global Risk Institute's **Canadian Financial Services Risk Outlook Survey 2023** gathers insight from financial services professionals into the types of risks facing the Canadian financial services industry today.

ECONOMIC ISSUES DOMINATE RISK AGENDA

The survey identified the top perceived risks to the Canadian financial system.

Economic risk has emerged as the top risk for the third consecutive year, with continued concerns that market conditions may significantly restrict growth opportunities for the financial services industry. However, this year's economic risk is starkly different to the ones experienced during the pandemic. Where the 2021 and 2022 results were about ensuring monetary and fiscal support to keep the economy on life-support, the start of this year now sees the economy fighting an inflationary bubble which could stall our recovery. Closely tied to the economy, **credit risk** became more prominent with debt servicing pressures increasing due to sustained above-average inflation driving up rates.

The rapid pace of technological change will continue to impact the financial services sector over the next several years. It is no surprise that **cyber risk** has maintained its prominence on the list, ranking it as their second highest risk concern.

Geopolitical risk has returned to the list after a three-year absence as we continue to experience strained relations amongst the world's superpowers, the war in Ukraine, and energy insecurity.

Almost half of participants continued to rank economic risk as the highest risk to the Canadian financial system

77% ranked inflation and other macroeconomic concerns amongst their top three risks to organizational growth ambitions

90% ranked cyber security in the top three risks to their organization's operational resilience

57% ranked the continued demand-supply gap in the labour market as their top risk concern for executing on their organization's talent and culture imperative

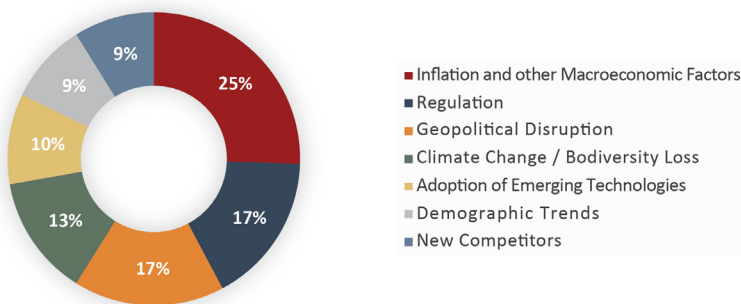
Rank	2023	2022	2021	2020
#1	Economic	Economic	Economic	Cyber
#2	Cyber	Cyber	Cyber	Geopolitical
#3	Credit	Climate	Climate	Economic
#4	Geopolitical	Credit	Pandemic	Consumer Debt
#5	Talent	Talent	Credit	Housing

In a post-pandemic world, **talent risk** maintained its position in the top five due to the tighter labour market, the introduction of hybrid work practices, and a greater desire for work-life balance.

Notably, climate risk has fallen out of the top five, with near-term economic concerns taking priority. Conversely, financial services firms may feel more comfortable managing and integrating climate risks into their operations, risk management frameworks, reporting, stakeholder relations, and other organizational functions. The climate theme remains a significant long-term risk, and we will continue to see policy, regulatory, and investor/shareholder impact.

RISK TO INDIVIDUAL ORGANIZATIONAL GROWTH

Inflation Poses Greatest Threat to Long Term Growth



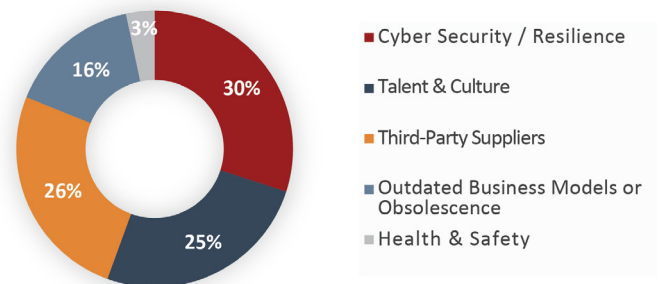
When asked to identify risks to organization-level growth over a five-to-ten-year horizon, **inflation and macroeconomic factors** were at the top of the list. Close to half of respondents (43%) ranked it as their greatest concern, and 77% ranked it in their top three perceived risks to long term growth. Supply chain impacts from **geopolitical disruption** have directly increased costs, further emphasizing why building a resilient ecosystem is necessary for sustained growth and is top of mind for Canadian financial institutions.

Growing **regulation** or the management of disparate rules by different regulatory bodies will continue to impact financial services firms that have a multi-jurisdictional presence needing to manage ever-more complex compliance programs. Vastly different regulations around

the world, such as those governing the appropriate use of AI and the numerous standards for environmental, social and corporate governance (ESG) reporting, have resulted in increased overhead costs.

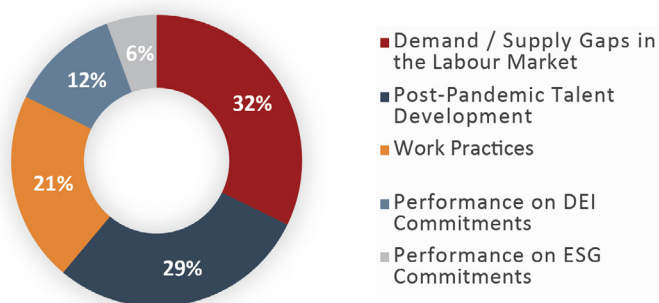
Despite not appearing in the top five current financial system threats, the impacts of **climate change/biodiversity** loss did rate as an impediment to long-term growth. Extreme weather events have been increasing, causing devastation to people, infrastructure and ecosystems. Last year, severe weather events caused an estimated \$3.1 billion in damages in Canada.

Cyber Security Poses Greatest Threat to Operational Resilience



It is widely held that when it comes to cyber threats, it is no longer a question of if, but when. The ever-changing nature of technology and the increased sophistication of **cyber security/resilience** threats make it less predictable than ever. As such, this threat to operational resilience ranked first with 90% of respondents ranking it in their top three. Further, risks around the reliance on third-party suppliers ranked highly with 77% of respondents selecting it in the top three. The concentration of outsourced digital services means that today's organizations are only as safe as the weakest link in their value chains. A prominent example of third-party failure that affected millions of customers of Canadian financial institutions was the July 2022 Rogers network outage. It caused the interbank network, Interac, to be taken offline affecting the banking services of businesses across the country.

Talent Risk Poses Second Greatest Threat to Operational Resilience



Canada's unemployment rate hit all-time lows in mid-2022 of 4.9%. In particular, employment growth in professional, scientific and technical services increased by more than 7% over the past year and accounted for the largest segment increase for a tightened labour market. Given that the financial services industry seeks to hire professionals with technology skills to help them achieve growth has created a **demand/supply gap in the labour market**.

Given the demand for talent and the low supply, **talent development** has become more important with 63% of respondents rating it in their top three. This is a critical element in an organization's talent retention strategy which is being challenged by the reduced friction of talent mobility (from online job boards, virtual interviews, and remote working) in the post-pandemic environment.

Employee expectations created during the pandemic around hybrid and virtual **work practices** continues to challenge the business models of our respondents. In the past year, organizations attempting to enforce full-time return to office have faced the reality that employees have the upper hand in a tight labour market. This situation will continue to evolve along with new challenges, such as managing mental health in a hybrid work environment.

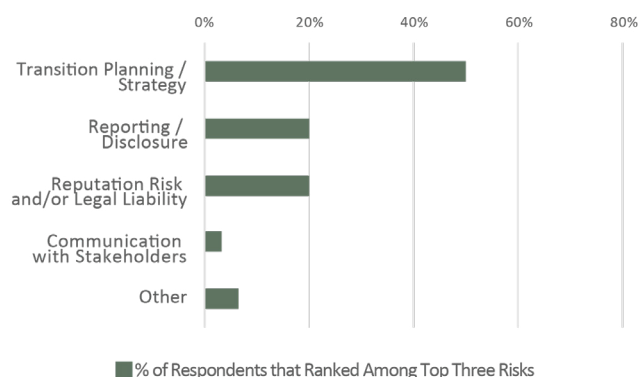
Finally, ensuring **commitment to DEI** was viewed as a risk with 37% ranking it in their top three. A lack of congruence and follow-through has potential to impact work force morale and trust in management.

FUTURE RISK CHALLENGES

Our survey captured members' assessments of future risks, including sustainable finance, technological innovation, and the longer-term global challenges of macroeconomic disruptions.

Sustainable Finance

Top Sustainable Finance Challenges (1-3 Year Horizon)



With Canada committing to net-zero greenhouse gas emissions by 2050, more than 50% of members identified improper **transition planning/strategy** as a threat. Action on climate requires investments in renewable energy and other low-carbon infrastructure, new research and development, and changes to lifestyles and consumption patterns. These investments can be particularly challenging to advance in times of economic strain making it difficult for organizations to confidently set strategy. The uncertainty has been further compounded in the past year with the global reaction to the issue of energy security, given fossil fuels are expected to play a critical role in ensuring resilience.

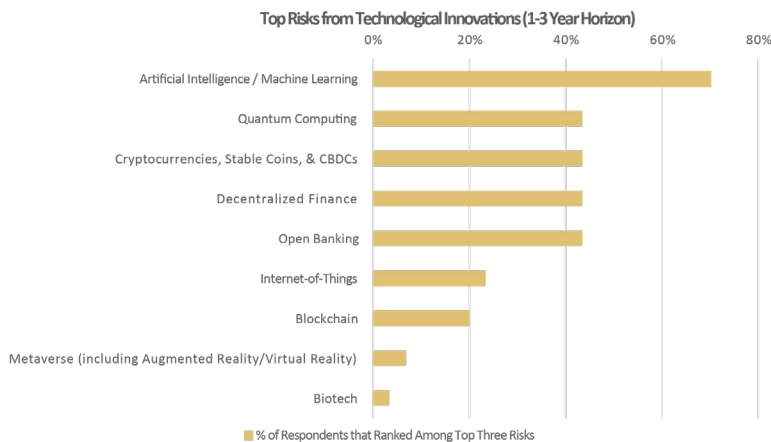
Continued uncertainty on **reporting/disclosure**, along with heightened scrutiny on ESG claims, not only exposed organizations to **reputation risk and/or liability**, but also has the potential to derail Canada's climate commitments.

Technological Innovations

70% of respondents ranked **artificial intelligence (AI)/ machine learning (ML)** as a top technological innovation that presents risk to their business.

Companies are now investing to understand how to implement the now widely available commercial AI/ML tools into their businesses, while ensuring they have an appropriate risk management frameworks to support its application. AI/ML applications provide efficiency gains promised from the “fourth industrial revolution” that are essential to counter the headwinds of future declining labour participation, cost increases from global supply chain decoupling, and meeting Canada’s climate change obligations.

Four other technologies (**quantum computing, cryptocurrencies, decentralized finance, and open banking**) were equally ranked after AI/ML. Each have different impacts depending on the business focus of the company that responded to the survey.

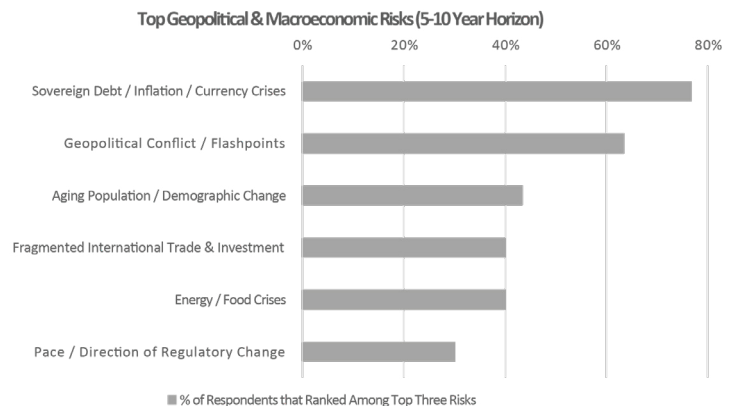


Geopolitical and Macroeconomic

Survey respondents were asked to look beyond Canada’s borders and select the three most significant geopolitical and global macroeconomic risks.

Sovereign debt/inflation/currency crises ranked as the most prominent concern, reflected in 77% of responses due to global inflationary pressures, interest rate hikes by major central banks, sovereign credit distress, and the pressure on national currencies of emerging markets.

The second most prominent challenge identified by respondents was **geopolitical conflict/flashpoints**. The Russian invasion of Ukraine in 2022 has marked the return of large-scale military conflict to the European continent. Other potential tensions raise additional concerns including strategic competition between the United States and China.



BACKGROUND

GRI's annual Risk Outlook Survey assesses the risk perceptions of our members in the Canadian financial services industry for the year ahead. It sheds light on how senior risk professionals view the challenges facing the financial sector and their institutions. The survey participants included banks, credit unions, insurance companies, crown corporations, government agencies, pension funds, and other asset managers. Responses to this year's survey were received between December 2022 and January 2023.

This report summarizes the results of the survey. It begins with the system-level view of the threats respondents identified to the Canadian financial services industry. Second, the survey report presents the firm-level view or member assessments of the risks to key priorities within their respective organizations, including growth, operational resilience, and talent and culture. Third, the report captures member assessments of specific risk themes that are topical focus areas for GRI, specifically sustainable finance, technological innovation, and the long-term global challenges of geopolitical/macro-economic disruptions.

DEFINITIONS FOR TOP 5 RISKS

Economic Risk: The likelihood that macroeconomic conditions (conditions in the whole economy) may affect an investment or a company's prospects, or existing business operations domestically or abroad.

Economic risks may include exchange rate fluctuations, a shift in government policy or regulations, political instability, or the introduction of economic sanctions.

Cyber Risk: Any risk of financial loss, disruption or damage to an organization's reputation from some sort of failure of its information technology systems.

Credit Risk: The possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations.

Geopolitical Risk: The potential for political, socioeconomic, military, and cultural factors (events, trends, developments, etc.) that can emerge from a nation's involvement in international affairs and affect businesses' vitality (stability and health/well-being).

Talent Risk: The potential for an organization to lack the right people (skills) in place at the right time to drive current and future business growth.

© 2023 Global Risk Institute in Financial Services (GRI). This "Canadian Financial Services Risk Outlook Survey 2022-23 A Global Risk Institute Survey of Financial Service Professionals" is a publication of GRI and is available at www.globalriskinstitute.org. Permission is hereby granted to reprint the "Canadian Financial Services Risk Outlook Survey 2022-23 A Global Risk Institute Survey of Financial Service Professionals" on the following conditions: the content is not altered or edited in any way and proper attribution of the author(s) and GRI is displayed in any reproduction.

All other rights reserved.