Highlights from the Bank Director's 2023 Risk Survey

risk management industry update

Summary: Managing further economic downturns, liquidity, and cybersecurity are just a few of the many concerns at the forefront of bank leaders' minds, according to Bank Director's 2023 Risk Survey. We summarize some of the key findings and suggest ways for CFIs to mitigate the challenges.

On December 2, 2021, 35-year-old Rafael Bridi broke the Guinness World Record for the highest slackline walk, after walking 59 ft. between two hot-air balloons — at an altitude of 6,236 ft. As someone accustomed to managing risk, Rafael also holds the world record for the longest slackline walk over an active volcano.

The financial services industry, of course, faces its own risks that are constantly in flux, given the changing macroeconomic and geopolitical landscape. Bank Director's annual risk survey outlines key banking trends, along with senior executives' concerns.

This year's report is based on the responses of 212 executives from US banks with less than $100B in assets. We discuss some of the report's key findings and what they might mean for community financial institutions (CFIs).

Navigating Continued Economic Uncertainty

Given the current economic environment, it is perhaps not surprising that bank leaders are most concerned about their organizations' abilities to navigate further economic downturns and any potential recession. The majority of the survey's respondents reported either "significant concerns" or "somewhat increased concerns" regarding interest rates (91%), credit risk (77%), and liquidity (71%). These concerns have all increased notably compared to the 2022 survey.

On a more positive note, business remains strong or "generally strong" for most financial institutions' business clients (93%), despite the ongoing uncertainty and inflationary pressures. That said, 75% report that although business is strong, some of their clients are having to pause or adjust their growth plans.

A third of respondents are reportedly worried about slowing credit demand. What's more, 50% of the respondents reported increased concerns about consumer risk, another significant increase compared to last year's survey.

Most respondents (76%) complete an annual stress test — with many adjusting how they do this in anticipation of an economic downturn. We discuss why CFIs of all sizes should consider more frequent stress testing, and ways to make the process easier in this recent article.

Managing the Balance Sheet

Despite economic pressures, 53% reported that their net interest margins (NIM) have improved over the past year. However, there was little consensus on the outlook for the next year: the survey had very mixed responses as to whether NIM would contract, expand, or remain the same.

To manage liquidity in the year ahead, 73% expect to raise their interest rate on deposits, while 62% plan to borrow funds from a Federal Home Loan Bank. Earlier this year, we suggested strategies that CFIs could employ to help manage their liquidity.

At the time of the survey,11% of respondents said they had experienced deposit loss that could impact their funding base significantly. However, 61% said that although they had experienced some deposit loss, this had only had a minimal or moderate impact.

Looking ahead, just over half of the respondents (51%) expect deposit pricing to be a key strategic challenge this year. The various ways you can overcome this challenge are highlighted in this BID article.

Dealing with Increased Cybersecurity Concerns

Cybersecurity ranked as bankers' most pressing concern in the 2022 survey, and unsurprisingly, it continues to be a top concern this year for 83% of the respondents.

That said, banks appear to be upping their game and taking appropriate action: 89% completed a cybersecurity assessment in the last year. Many of those have gone on to improve their threat detection technology and internal communications and controls, and provide training for bank staff — some of the changes most likely to help counter risk.

As we discussed recently, regulators are stepping up their oversight of cybersecurity and preparing to impose new regulations. CFIs would do well to review their cybersecurity programs and update them if necessary. This may include completing a cybersecurity assessment — the majority of respondents use the Federal Financial Institutions Examination Council's assessment tool — if they haven't done so already.

Focusing on ESG

According to the survey, slightly more banks' boards discuss climate change at least annually compared to last year (21% up from 16%). However, 61% don't believe they focus on environmental, social, and governance (ESG) issues in a comprehensive manner.

However, two-thirds of respondents said they have goals and objectives linked to employee development, community needs, and investment. Meanwhile, around 42% have goals for diversity, equity, and inclusion (DEI) and corporate governance processes. Less encouragingly, only 5% have objectives related to climate risk, and only 6% linked to green initiatives and sustainability.

With ESG factors becoming increasingly important to many stakeholders, they will continue to impact the banking industry. This BID article suggests some ways in which you can demonstrate your ESG commitment.

Given the uncertain outlook for the macroeconomic environment, the survey results highlight the importance of CFIs remaining abreast of the key existing and emerging risks and challenges, and putting robust strategies in place to mitigate them.

TWO APPROACHES TO STRESS TEST YOUR LOANS

ECONOMY & RATES

Rates As Of: 05/18/2023 11:43AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.26	0.16	0.84
6M	5.30	0.24	0.54
1Y	5.00	0.26	0.29
2Y	4.24	0.24	-0.18
5Y	3.69	0.21	-0.31
10Y	3.65	0.22	-0.23
30Y	3.90	0.22	-0.07

FF Market	FF Disc	IORB
5.08	5.25	5.15
SOFR	**Prime**	**OBFR**
5.05	8.25	5.07