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Too-Big-To-Fail Companies Failing To Plan

By Max Rudolph, actuary and risk-management expert and author of the annual Risk Manager Survey of Emerging Risks

New survey findings shed light on the question: If a company isn't prepared for a rainy day, how can it possibly handle a hurricane? That's exactly the kind of question financial companies like JPMorgan should be asking themselves.

Real-World Risks: A JPMorgan Case Study

To truly understand the significance of these survey findings, just consider the JPMorgan London Whale incident that jolted stakeholders across the financial sector. The fallout has raised important questions about how – and whether – institutions have improved their approach to risk management in the aftermath of the financial crisis. In fact, in March 2013, the U.S. Senate Subcommittee on Investigations published a report, which stated that "the bank's actions not only exposed the many risk management deficiencies at JPMorgan Chase, but also raise systemic concerns about how others may be disregarding risk indicators and manipulating models to artificially lower risk results and capital requirements." This should serve as a major red flag for the financial services industry, as the risk culture at JPMorgan was once considered best practice.

The Good, the Bad & the Ugly: Significance of the Survey Findings

The Emerging Risks Survey results show a growing recognition of the need to update and improve the risk modeling process, but also indicate a number of trends that reflect the concerns expressed in the U.S. Senate committee report. These trends are particularly encouraging for the types of practices and controls that either failed or were entirely absent from JPMorgan's process. In fact, the top three most frequently reported modeling improvements cited by survey respondents in 2012 – peer review (52%), transparency (43%) and communications (43%) – were all areas that were repeatedly identified in the U.S. Senate's report as deficiencies in the London Whale story. Another source of potential anxiety stems from a discrepancy between expected growth in activity and funding levels. Specifically, the survey found that while 66% of respondents expect an increase in activity, only 38% anticipate an increase in funding. What's more, a small number (5%) actually anticipate decreased funding for ERM activities.
Emerging and previously unforeseen risks are evolving and changing every day, fundamentally altering the environment and markets in which businesses operate. To help executives effectively manage these risks, throughout 2013, the Society of Actuaries (SOA) will publish a series of "Risky Business Bulletins," providing insight and

expertise on critical business issues from industry-leading enterprise risk management (ERM) actuaries. Each Bulletin will explore key areas of risk that need attention as we work to rebuild the global economy and offer real-world solutions for managing the entire spectrum of risks.

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