PRESS REVIEW COPY

Contact Jennifer Massing Harris with questions and interview requests at jenm@massingpr.com or 917-293-2405

Emerging risks in 2022

The challenges and opportunities ahead

Risk Universe
by RiskBusiness

It's always tricky to put together a list of emerging risks in January of each year – after all, almost no one saw a Covid-19 pandemic causing a mass exodus to remote working in December 2019. The world seems to be moving beyond the pandemic now, with 2022 bringing a fresh wave of challenges. This list of emerging risks for 2022 is the result of collaboration among the team here at RiskBusiness and while it highlights some significant emerging risks ahead, within them are often significant new horizons for today's financial firms and companies. In this coming year in particular, the definition of risk as being about both potential downside and upside rings particularly true.

PEOPLE RISK AND THE GREAT RESIGNATION

While the Great Resignation was in the headlines in 2021 as a side effect of the Covid-19 pandemic, recruitment experts say the worst is yet to come for companies and financial services firms in 2022. According to a survey of 6,000 white collar workers by a recruitment firm, 72% of professionals are expecting a pay increase in New Year. However, according to the recruiter's poll of 500 companies, just a quarter of employers plan to give pay rises. Nearly two-thirds of professionals plan to leave their job if they don't receive a pay increase in the New Year. According to the recruiter, this Great Pay Divide will result in The Great Resignation peaking in February or March 2022, post-January appraisals – professionals with in demand skill sets in legal, accounting and finance are achieving 20-30% pay rises when moving roles. In technology, the pay rises can reach 50% for individuals with software development or cyber security experience. For companies, this can mean it will be even more difficult to recruit for GRC roles, where seasoned professionals have always been in short supply. In some industries, such as financial services, where there has been a talent shortage in many areas over the past few years, people risk could grow significantly. The inability to hire the right talent could lead to gaps or errors in processes, compliance failures, or poorly managed risks, for example. However, firms that are able to attract and retain top talent will find themselves at a competitive advantage.

DIGITAL FINANCE RISKS

Digital finance and digital assets, such as Bitcoin, have grown phenomenally over the past 10 years, now reaching almost US$3 trillion in market value. The growing sophistication of these markets is evidenced by the fact that trading volumes of derivatives based on digital assets now regularly outpace those of the underlying assets. For example, in June 2021, trading volumes in digital asset derivatives across all trading venues amounted to $3.2 trillion, surpassing those of spot transactions and achieving a 53.8% market share of the total market in digital assets. According to a recent analysis, this represents an almost eight-fold increase in global trading volumes in digital asset derivatives since June 2019. As most seasoned GRC professionals know, this kind of tremendous growth brings a whole range of risks with it. Regulators around the globe, including the Basel Committee, are formulating digital finance rules and industry bodies, such as ISDA, are publishing their own standards and definitions. However, the accelerating growth of these markets almost certainly means that the rules will be steps behind where the markets are – for example, in June 2021 the Basel Committee published a consultation paper on the prudential treatment of cryptocurrency assets and, as of early January 2022, the next stage of rulemaking is yet to take place. Rulemaking is also very fragmented across jurisdictions, making things even more challenging for financial services firms. In this kind of environment, firms need to think proactively about how to anticipate and manage potential risks related to digital assets, such as legal risks related to contracts, operational risks around the trading of these assets and compliance risks as the rules come into force. Firms should also consider potential reputational risks around these assets as risk issues emerge into the public eye.

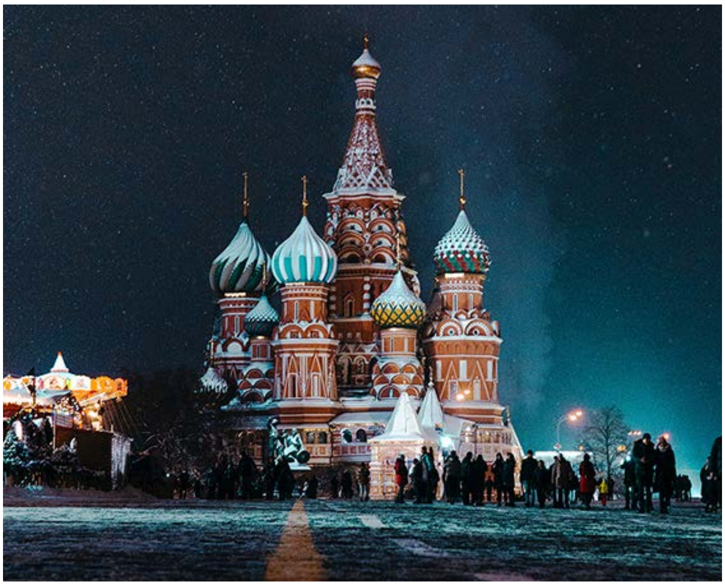
> **Digital finance and digital assets, such as Bitcoin, have grown phenomenally**

POLITICAL RISKS

While the change in administration in the US has led to an overall policy approach that is more aligned with the global direction of travel in many areas, political risk around the globe is growing. There are continued attempts to engage certain countries with the global financial system – for example, ISDA recently published a white paper that explores the development of China's derivatives market and recommends policy measures to promote the safety, robustness and efficiency of the market. However, at the same time, the lack of transparency around the origins of the COVID pandemic has led to a certain cooling of relations between China and the US and Europe, while China's sabre rattling at Taiwan continues to jangle nerves. Also, Russia is said to be amassing arms at the border with the Ukraine, threatening to

As with most conflicts today, the US, EU, Russia and China are often stakeholders behind the scenes

provoke a "hot war" in that country. In fact, in spite of everything that was going on in 2020, the number of conflicts hit a record high in 2020, with more active conflicts than at any time since 1945, according to a report published in September 2021. This trend was expected to continue into 2021 and 2022. Conflicts that hit the headlines less often include Ethiopia, Syria, Myanmar, Congo, South Sudan and Yemen. As with most conflicts today, the US, EU, Russia and China are often stakeholders behind the scenes and so the risks that a national or regional conflict could mushroom into a more international issue is always present. All firms need to ensure they are abiding by the anti-money laundering and anti-bribery & corruption rules related to the countries involved in these conflicts. Also, companies should examine their supply chains to ensure these are not impacted by sanctions or ethics lists. If companies or financial firms do have links to these countries, they should ensure the operational resilience of business processes related to them. More broadly, financial firms and companies should do a scenario exercise that involves conflict escalation that would impact them.



ENVIRONMENTAL MORPHING INTO LEGAL RISKS

One of the broadest emerging risks for 2022 is environmental risks that turn into legal risks for a broad range of companies and financial firms. Already, individual litigants are winning cases, such as the Dutch case against Shell, when a judge in The Hague ordered the company to cut its carbon emissions by 45% by 2030. Shell's appeal is due to be heard in 2022. Experts are now predicting an "avalanche" of similar cases to be brought. For financial services firms facing a barrage of new environmental transparency and disclosure laws, there are risks that gaps in their environmental governance around investment products could be litigated as greenwashing – making a disclosure or marketing material seem more environmentally friendly than the underlying situation actually is. Regulators are already clearing their throats around potential greenwashing. They are egged on by the International Organization of Securities Commissions (IOSCO), which would like all jurisdictions to have clear rules around environmental governance and transparency. Where rule-making and enforcement actions go, litigation in the courts is sure to follow. Firms should consider reviewing their existing environmental governance and transparency policies and processes today against a robust standard – if their jurisdiction does not already have rules in place – to minimise the potential for greenwashing and other forms of environmental litigation in the future.

OPEN BANKING RISKS

The Open Banking project in the UK – which is essentially a project that is designed to make it easier for customer data to flow between financial services firms, via APIs, to enhance competition among those firms – has continued to develop. For example, recently NatWest was the first UK bank to conduct a live transaction using Open Banking-initiated Variable Recurring Payments (VRPs). VRPs enable customers to connect authorised payments providers to their bank account so that the payment providers can make payments on the customer's behalf within agreed parameters. However, the risks associated with Open Banking are also becoming more evident too. For example, there are risks associated with the third parties within the Open Banking system, potential process risks, technology risks, and data risks. There are also significant concerns that AML, counter-terrorist funding and KYC processes that firms may currently have are insufficient to meet regulatory obligations within an Open Banking context. There are fears that these risks could lead to an increase in fraud within the UK. Firms working with Open Banking should also consider the operational resilience implications of engaging with the platform. Managing the risks around Open Banking would be a good area for financial services firms to collaborate on during 2022.

> **Former US President Donald Trump launched a SPAC in 2021 that sparked furious trading**

THE RISE (AND FALL?) OF SPACS

Special Purpose Acquisition Companies (SPACs) are being used in the US equity markets to facilitate initial public offerings (IPOs). These publicly traded "shell companies" raise capital in an IPO process and then use that capital to merge with a privately held business. Some commentators have likened them to a blank cheque designed solely to merge with another company. For example, former US President Donald Trump launched a SPAC in 2021 that sparked furious trading, even though little was known of the underlying fundamentals of the business. Digital World's shares shot up by 1,657% after a deal to merge with the Trump Media & Technology Group (TMTG) was announced, although commentators noted that the investor presentation materials contained errors. Other celebrities have been associated with SPACs and the vehicles have been a method used by some FinTechs to speed the IPO process. The recent popularity and use of SPACs have rung alarm bells with regulators. In the US, Securities and Exchange Commission (SEC) Chair Gary Gensler warned companies against using SPACs as a way to avoid the red tape associated with a more traditional public offering and said that the SEC would be tightening scrutiny of firms it felt were using SPACs in this way. The UK FCA issued final rules to strengthen investor protections around SPACs in late July 2021. Financial firms should carefully consider why a client wishes to use a SPAC, as well as their own compliance obligations, particularly around misselling to investors. Companies should think

> Vulnerable customers may require additional measures to ensure good outcomes and their needs

about the potential compliance and legal risks associated with increased regulatory scrutiny around them. This includes potential lawsuits from disgruntled investors in the event of any enforcement action, or underperformance of the SPAC arrangement for investors.

FINANCIAL SERVICES AND THE VULNERABLE

According to one law firm, a "vulnerable customer is somebody who, due to their personal circumstances, is especially susceptible to harm particularly when a firm is not acting with appropriate levels of care. Vulnerable customers may require additional measures to ensure good outcomes and their needs are likely to vary significantly. There is a huge array of different circumstances that may lead to a customer becoming vulnerable and the UK FCA's guidance should not be taken as containing the only indicators of vulnerability. Instead, the FCA refers to vulnerability as "a spectrum of risk." The FCA published a paper in 2014 on the consumer experience of vulnerability when accessing financial services, which was followed in February 2021 by FCA guidance on the fair treatment of vulnerable customers. One of the more interesting aspects of the FCA's operational resilience programme is its insistence that firms take into account the vulnerable when planning their resilience programmes. Specifically, firms need to consider the vulnerable when setting their impact tolerances and also plan how they will communicate with vulnerable customers in the event of a business disruption. UK banks are beginning to respond – a group of them recently announced the launch of shared banking hubs in communities where bank branches have closed. The rate of bank branch closures increased dramatically in 2021, cresting between June and August when 298 branches shut down, an average of 99 per month, according to consumer campaigning group Which?. Certain types of vulnerable people – such as the elderly – have been hit hard by the branch closures. Also, although some FinTechs are working to develop solutions to support different types of vulnerability, there are also concerns that Open Banking could negatively impact vulnerable consumers. Financial services firms can expect much more action on the treatment of vulnerable customers in 2022 from the UK FCA. This is a theme that is beginning to spread internationally and so financial firms in other jurisdictions can expect their regulators to begin to explore this area in the coming months too.

THE COMING OF CENTRAL BANK DIGITAL CURRENCY (CBDC)

So far, there has been quite a lot of talk about CBDCs, but little action. Just what are CBDCs? According to the Bank of England, central banks provide physical money (banknotes), which is used by households and businesses to make payments and they also provide electronic money. However, at the moment, electronic money can only be used by banks and selected financial institutions. CBDC would make electronic money, issued by a central bank, available to all households and businesses, enabling everyone to make electronic payments in central bank money. The development of CBDC has been spurred on by both the rapid development of private digital currencies and fears that such currencies are developing beyond the monetary and regulatory authority of governments. In November 2021, HM Treasury and the Bank of England announced that they will launch a consultation that will "set out their assessment of the case for a UK CBDC, including the merits of further work to develop an operational and technology model for a UK CBDC." The UK isn't the only country working on CBDCs – many countries have programmes at different stages. The most developed digital currency is in the Bahamas, while China is also at advanced stages with its CBDC, announcing the availability of a Digital Yuan wallet via the e-CNY app on January 5th, 2022. Financial services firms are keen to embrace the opportunities that both CBDCs and private digital currencies might provide – and many already are. However, there is much complexity for firms to navigate, including the fact that this space is largely unregulated globally. Experts acknowledge that significant regulation will need to be brought in to properly manage CBDCs and private cryptocurrencies over the next few years. Financial services firms will need to move with some caution in this area and should engage with their regulators whenever the opportunity arises to keep the flow of information going. Risk management tools such as scenario analysis might be particularly helpful in enabling the business to think through both the risks and opportunities associated with the introduction of CBDC and private cryptocurrency products and processes.

> **The most developed digital currency is in the Bahamas while China is also at advanced stages**

THE FUTURE OF BLOCKCHAIN

Blockchain was once hailed as the future of finance, but over the past few years, it has sometimes seemed as though the technology's critics are winning the argument. For example, the Bank for International Settlements published a paper in December 2021 that calls out specific challenges with blockchain technology in terms of governance. The paper argues that without proper governance around blockchain transactions, the consensus mechanism that is part of the blockchain system could result in the concentration of power in the hands of those who would not use that power for good. Academic research is showing the truth of this, with bots frontrunning cryptocurrency transactions on blockchain platforms. Nonetheless, banks are pressing ahead with using the technology in some back-office processes. For example, HSBC and Wells Fargo announced in December 2021 that they will be settling their FX trades directly between themselves using blockchain. This cuts out the role of CLS, a utility with 70

> **As with digital assets and CBDCs, so much is so new and regulatory action is playing catch-up**

large financial institution members and 28,000 users, which was created to reduce systemic, financial and operational risks associated with trade failures. Also, in December 2021, JPMorgan and Siemens announced that they are using blockchain to automate certain kinds of payments between the two organisations. The system was developed by JPMorgan's blockchain unit, Onyx, which says it has a waiting list of other firms interested in using the new technology. JPMorgan has also used crypto coins and its own blockchain technology for bank-to-bank transactions for more than 400 institutions. Another project has blockchain aggregating and distributing market data to financial services firms. Even the UK FCA admits that blockchain could be useful for regulatory reporting – it is exploring using the technology to speed up and increase the accuracy of the information it receives from financial firms. So, at the moment, the opportunity – and risks associated with – blockchain seems to depend on the kind of application it is being used for. As with digital assets and CBDCs, so much is so new and regulatory action is playing catch-up with what is evolving within the industry. Companies and firms should consider the strength of any third party relationships that involve blockchain, as well as the potential regulatory view of the activities that are being undertaken.

SUMMARY

As the world hopefully emerges from or learns to live with the Covid-19 pandemic, there are set to be an interesting portfolio of fresh emerging risk challenges for financial firms and companies alike to tackle. Firms should seek to minimize these risks by collaborating with other firms through industry associations, groups sponsored by regulators and other forums to share information about risks and potential management of them – particularly when risk could be systemic in nature. At the same time, many of the emerging risks on this list also contain the seeds of significant opportunity – making these very exciting times indeed!

FURTHER READING

Robert Walters report on The Great Resignation
https://www.robertwalters.co.uk/salarysurvey.html?utm_source=PR

CryptoCompare Exchange Review June 2021
https://www.cryptocompare.com/media/37748193/cryptocompare_exchange_review_2021_06.pdf

Basel Committee consults on prudential treatment of cryptoasset exposures
https://www.bis.org/press/p210610.htm

ISDA – Contractual Standards for Digital Asset Derivatives
https://www.isda.org/2021/12/14/contractual-standards-for-digital-asset-derivatives/?_zs=LeKTO1&_zl=ko1X6

Financial Times – Regulators race to catch up with the digital assets boom
https://www.ft.com/content/c997d3d6-8998-449b-991e-d7798dde32a0

ISDA Publishes Whitepaper on Developing Safe, Robust and Efficient Derivatives Markets in China
https://www.isda.org/2021/12/15/isda-publishes-whitepaper-on-developing-safe-robust-and-efficient-derivatives-markets-in-china/

IISS – The Armed Conflict Survey 2021
https://www.iiss.org/blogs/podcast/2021/09/the-armed-conflict-survey-2021

Financial Times – Lawyer who defeated Shell predicts 'avalanche' of climate cases
https://www.ft.com/content/53dbf079-9d84-4088-926d-1325d7a2d0ef

Financial Times – Regulators step up scrutiny over investment industry 'greenwashing'
https://www.ft.com/content/cad22116-778a-4327-9bc3-6a7688ce6f76

Finextra – NatWest initiates first live Variable Recurring Payment transaction
https://www.finextra.com/newsarticle/39404/natwest-initiates-first-live-variable-recurring-payment-transaction?utm_medium=dailynewsletter&utm_source=2021-12-16&member=22821

TerraData Blog – Look Out for Risks in Open Banking!
https://www.teradata.co.uk/Blogs/Look-Out-for-Risks-in-Open-Banking

FICO blog – 8 Risks Open Banking Poses to Financial Crime Compliance
https://www.fico.com/blogs/8-risks-open-banking-poses-financial-crime-compliance

Finextra – Will Open Banking lead to the Next Wave of the UK's Fraud Epidemic?
https://www.finextra.com/blogposting/20294/will-open-banking-lead-to-the-next-wave-of-the-uks-fraud-epidemic

Risk Universe
by RiskBusiness

Finerva – What Is A SPAC And Why Are So Many Companies Using It To IPO?
https://finerva.com/report/spac-ipo-2020/?gclid=EAIaIQobChMI39a4-cKL9QIVdGHmCh2wnggUEAAYAyAAEgJHFfD_BwE

CNN Business – 'This is weird and murky.' Trump SPAC deal values firm at more than $10 billion despite red flags
https://edition.cnn.com/2021/12/14/investing/trump-spac-dwac/index.html

Bloomberg – Gensler Warns Executives Against Using SPACs to Shirk U.S. Rules
https://www.bloomberg.com/news/articles/2021-12-07/gensler-warns-executives-against-using-spacs-to-shirk-u-s-rules

UK Financial Conduct Authority – FCA publishes final rules to strengthen investor protections in SPACs
https://www.fca.org.uk/news/news-stories/fca-publishes-final-rules-to-strengthen-investor-protections-in-spacs

Simmons & Simmons – Treatment of vulnerable customers - a hot topic for retail banks
https://www.simmons-simmons.com/en/publications/cklmk1hp41io00a182w7pwidq/treatment-of-vulnerable-customers---a-hot-topic-for-retail-banks

UK Financial Conduct Authority – Vulnerability exposed: The consumer experience of vulnerability in financial services
https://www.fca.org.uk/publication/research/vulnerability-exposed-research.pdf

UK Financial Conduct Authority – Finalised guidance FG21/1 Guidance for firms on the fair treatment of vulnerable customers
https://www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf

UK Financial Conduct Authority – Building operational resilience: Feedback to CP19/32 and final rules
https://www.fca.org.uk/publication/policy/ps21-3-operational-resilience.pdf

Finextra – Major UK banks to roll out shared banking hubs
https://www.finextra.com/newsarticle/39403/major-uk-banks-to-roll-out-shared-banking-hubs

The Finance Innovation Lab – Open Finance and Vulnerability: A Policy Discussion Paper
https://barrowcadbury.org.uk/wp-content/uploads/2021/07/Open-Finance-doc_FINAL_2021-1.pdf

Bank of England – Central bank digital currencies
https://www.bankofengland.co.uk/research/digital-currencies

Bank of England – Statement on Central Bank Digital Currency next steps
https://www.bankofengland.co.uk/news/2021/november/statement-on-central-bank-digital-currency-next-steps

Atlantic Council – Central Bank Digital Currency Tracker
https://www.atlanticcouncil.org/cbdctracker/

Financial Times – What are central bank digital currencies?
https://www.ft.com/content/d65ad7d4-6f31-4a9e-8a96-72560c3be742

JD Supra – US Financial Services Firms Announce Crypto Initiatives
https://www.jdsupra.com/legalnews/us-financial-services-firms-announce-5201356/

World Economic Forum – Digital currencies are cutting across borders. Here's how regulators can catch up
https://www.weforum.org/agenda/2021/12/cbdc-stablecoin-digital-currency-regulation/

Bank for International Settlements – DeFi risks and the decentralisation illusion
https://www.bis.org/publ/qtrpdf/r_qt2112b.pdf

Cornell Chronicle – Bots exploiting blockchains for profit
https://news.cornell.edu/stories/2019/04/bots-exploiting-blockchains-profit

Financial Times – HSBC and Wells Fargo to settle currency trades with blockchain
https://www.ft.com/content/1a4dcaf5-2b4b-4f0b-8c58-a8fa173f24b3

Financial Times – JPMorgan develops blockchain system for Siemens' payments
https://www.ft.com/content/e14582fc-a154-4c96-9d65-9bc86c89a7a3

Financial Times -- Bankers quietly mould crypto innovations for their own use
https://www.ft.com/content/b8d78b6b-a7fa-4525-8c68-99c468aac241

Financial Times – Crypto data project backed by big high-speed traders set to launch
https://www.ft.com/content/245e3bd1-c270-4186-bdc5-7f4200ad5923

Finextra – FCA to use blockchain to speed up regulatory reporting
https://www.finextra.com/newsarticle/38891/fca-to-use-blockchain-to-speed-up-regulatory-reporting

About Risk Universe

Risk Universe by RiskBusiness provides in-depth analysis, reviews and research on areas of interest within the broader governance, risk, audit and compliance landscape, designed to provide proactive, 360° intelligence for informed decision making across the enterprise.

About RiskBusiness

RiskBusiness is an international governance, risk, audit and compliance (GRAC) solution provider, delivering risk content, risk intelligence, risk tools and risk advisory services to its clients. It is an association of like-minded industry professionals, who have the aim of furthering the risk management discipline to enable better risk-reward decision making.

Risk management is an evolving discipline, which has developed in close partnership with the industry. RiskBusiness has, both as individuals and collectively, a depth of established relationships with leading players and regulators in the operational risk field. We are also active participants in industry working groups and contribute thought leadership through publications and education.

RiskBusiness was founded in 2003 and today has principal locations in Birmingham, London, Buenos Aries, Amsterdam, Hong Kong, New York, Singapore, Toronto, and Zurich. To learn more, visit **www.riskbusiness.com**

Contacts

Jennifer Massing Harris:
jenm@massingpr.com

Carrie Cook, Editor:
carrie.cook@riskbusiness.com

General enquiries:
info@riskbusiness.com

www.riskuniverse.com

Risk Universe by RiskBusiness

www.riskbusiness.com