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JFSC Severity Survey Results

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The JFSC Severity Survey

At the JFSC we recently set out the risks we had identified in the financial services sector in our Risk Overview.

It is important that the JFSC and Industry have a shared understanding of those risks, and we also want to be transparent about the way in which we will assess them.

At present, the risks we have identified are not weighted or prioritised. This means, for example, that where the probability of the risk of loss of confidential information and the risk of terrorist financing occurring are equal within a firm, they would be considered to have the same level of impact on the Guiding Principles.

In reality, the risks we have identified are not equally serious. Severity scores reflect how serious we believe different risks are in their relative potential to impact on the Guiding Principles.

The new severity component of our approach influences the weight and priority given to specific risks in our assessments.

How do we measure the severity of a risk?

Each of the impact risks we have identified will have a percentage severity score which will place it relative to, and in context with, all other impact risks.

So, for example, if it is considered that the risk of terrorist financing inherently has more potential to impact on the Guiding Principles than the risk of a conflict of interest, it will be allocated a higher severity score.

We currently do not have consistent quantitative information to inform how severe risks are in relation to one another, so to help us understand the relative seriousness of risks to the Guiding Principles, we asked Industry to take part in a simple online survey.

This had already been completed by JSFC staff and our objective was to build a clear picture of what the JSFC and Industry see as being the key risks to manage, which should then become the focus of our supervisory activity.

It was also an opportunity to see where the views of the JFSC and Industry may differ.

How did the survey work?

The survey used a technique called maximum difference scaling that allowed measurement of the preference or importance people give to each of the impact risks in the Overview. The advantage of this technique is that it enables robust scaling to be applied without the need for ranking or rating of each and every risk by all participants. This technique also establishes the intensity of the difference between risks, which a simple ranking approach could not.

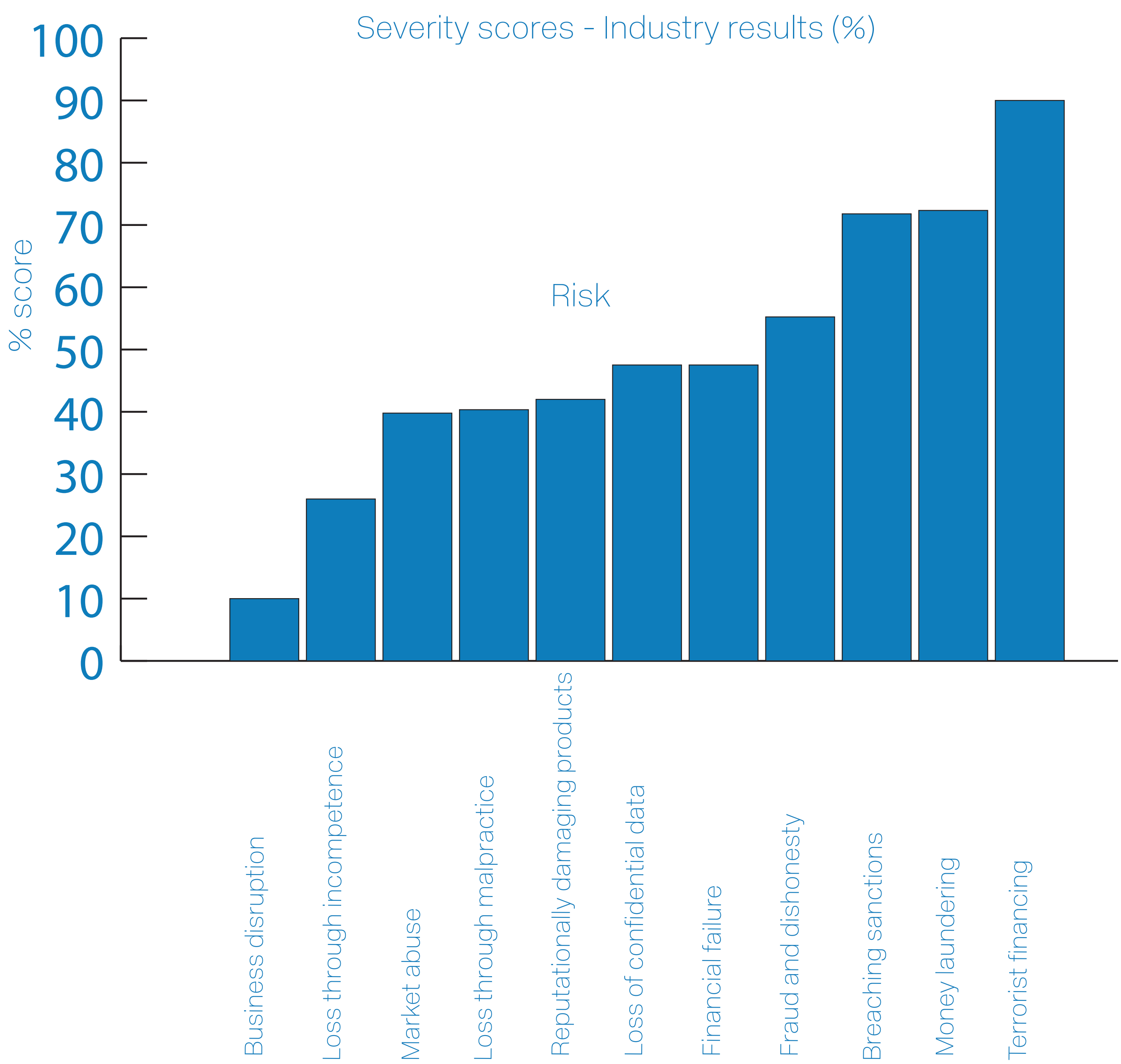
In the survey, each respondent was asked to complete twelve questions. In the first question, a random selection of just four risks was displayed and the respondent was asked to select which of the selection of four risks they believed was the most severe and which was the least severe in terms of the harm they could cause to the Guiding Principles. In the next question, four random risks were again displayed (some of which may have been asked in the previous question) and a judgement was again entered about the most and least severe risks. This process was completed for 12 questions.

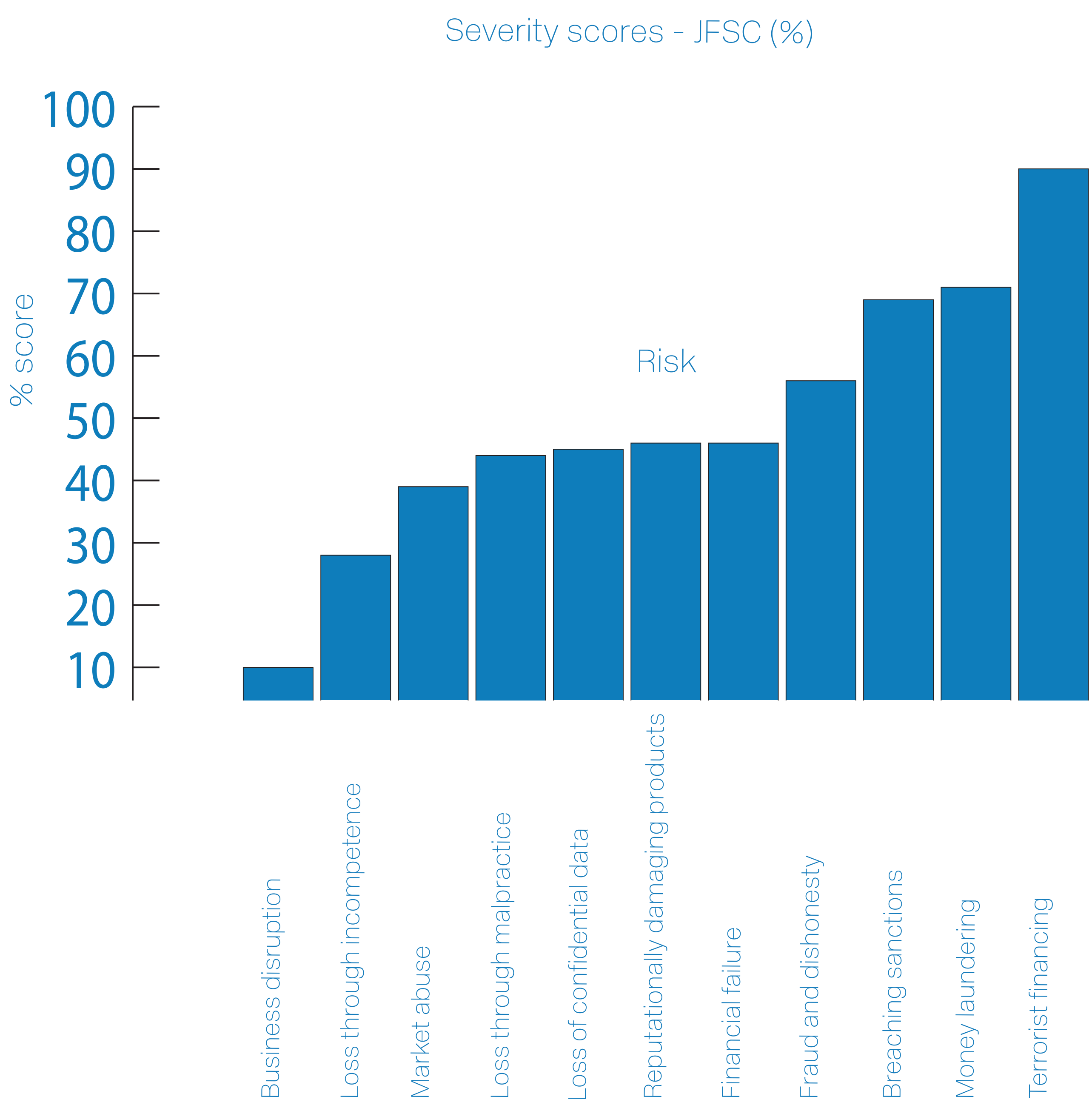
The responses provided in each of the 12 questions - whether a risk was selected as the most or least severe, or if a risk was not selected – were collected from each respondent. A single respondent's results in isolation had limited value, but by aggregating responses together information could be generated on the severity of the full selection of risks.

The response from Industry was very positive; of approximately 300 possible participants, 113 responses were received. This gives us a robust picture of Industry's view of the severity of impact risks in the Overview.

What were the results?

The results of the questionnaire were translated into percentage scores that represent the relative severity of each risk. The following charts compare the aggregated results from Industry and JFSC staff.




Severity scores - JFSC (%)
100
90
80
70
60
50
40
30
20
10
% score
Risk
Business disruption
Loss through incompetence
Market abuse
Loss through malpractice
Loss of confidential data
Reputationally damaging products
Financial failure
Fraud and dishonesty
Breaching sanctions
Money laundering
Terrorist financing

The results of the two surveys were very similar, showing a significant degree of alignment in our respective views of risk.

The top 4 risks all involved financial crime risks, with a common view of severity being held:

Risk	Industry Severity Score	JFSC Severity Score
Terrorist financing	90%	90%
Money Laundering	72%	71%
Breaching Sanctions	72%	69%
Fraud	55%	56%

There was also a common view of the two risks that were viewed as least serious:

Risk	Industry Severity Score	JFSC Severity Score
Business disruption	10%	10%
Incompetence	26%	28%

Although there was a common view of the degree of severity represented by those risks that largely involve conduct, with that grouping of risks scoring between 40 and 45%, the precise order differed between the JFSC staff and Industry results.

The clustering of the actual scores, however, reflects further significant agreement on the severity of those risks.

There was a significant difference, however, in the view of JFSC staff with responsibility for bank supervision when it came to the risk of financial failure of a regulated firm.

The view of those staff, perhaps unsurprisingly given JFSC's view that some of the banks we supervise are systemically important, was that the risk of financial failure of a bank would have the highest impact and attracted the highest severity score.

Sector Difference

The results of the industry survey were very similar across the different sectors, with the exception of the risk of loss of confidential information.

This risk ranked fifth overall in the aggregated results for industry, and in most of the sectors the ranking was similar, however for the banking and investment sectors, this risk was ranked much lower, in ninth place.

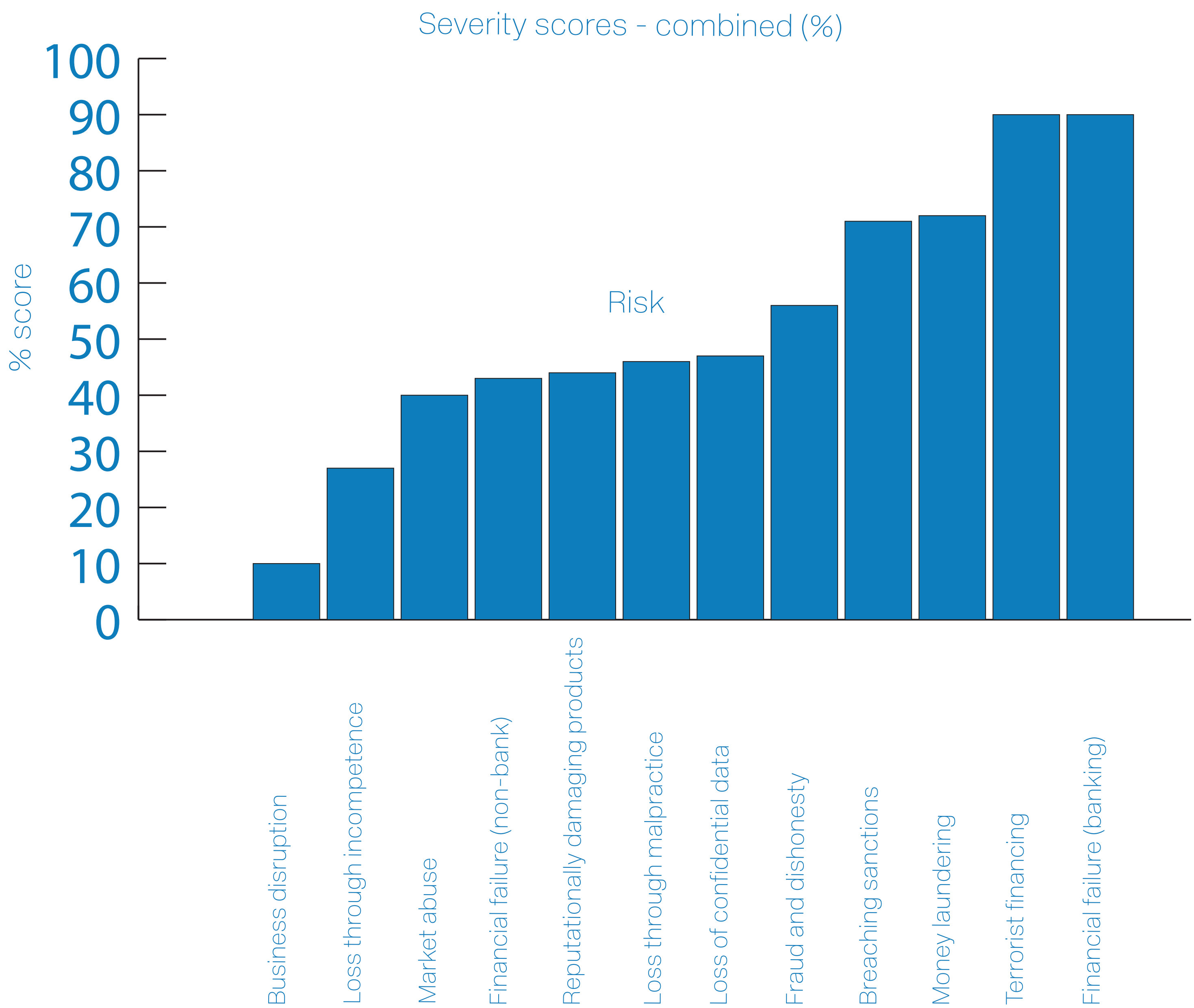
This difference in ranking, however, does not represent a significant difference in severity scores across sectors, with scores for this risk falling within the 40-45% band across all sectors.

What next?

These scores will be used directly in the JFSC's developing risk model, as one component of the assessment of risk across our regulated firms.

Given the degree of similarity between the aggregated results for industry and JFSC staff - with the exception of financial failure - we have averaged out the two sets of results to produce the scores to be used in our risk models for most firms, meaning Industry views are directly incorporated in our assessments of risk.

We have taken the view that the financial failure of a bank would have a significantly higher impact than the failure of other firms, and warrants an amendment to the severity scores for that risk.



The JFSC would like to thank all who completed the survey. Managing risk in the financial services sector is a task shared between the JFSC and Industry, and having a common understanding of the risks is an important step towards that goal.

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