Julia: **Hello and welcome to this DerivSource podcast.**

I'm Julia Schieffer, the founder and editor of DerivSource.com

Risk in the markets is constant but it is also ever changing and it presents real challenges and concerns for financial institutions. Geopolitical risk and cyber risk were both cited as top risk concerns in DTCC's recently published Systemic Risk Barometer report.

In this DerivSource podcast, I'm speaking to Mike Leibrock, DTCC's Chief Systemic Risk Officer, about the results of this report to really shed some light on these risk concerns and to better understand where we go from here.

Welcome to the podcast Mike.

Mike: Thank you very much.

Julia: **So Mike, can you give our audience a little bit of background to yourself before we begin.**

Mike: Sure. My name is Michael Leibrock, I'm currently Managing Director, Chief Systemic Risk Officer and Head of Counterparty Credit Risk for DTCC, based in Jersey City.

Julia: **So today we're talking about the Systemic Risk Barometer report, can you tell us a little bit about this report and what you do to assess systemic risk and how you gather your conclusions.**

Mike: The DTCC Systemic Risk Barometer survey which was started in 2013 primarily serves as a semi-annual pulse check that monitors emerging trends on significant risks that may impact the safety, resilience and stability of the global financial system.

We utilize the survey to benchmark the DTCC's Systemic Risk Office portfolio of projects and mitigate the risks and concerns that are front of mind for our member firms as well as to drive our systemic risk outreach initiatives.

Survey questions ask respondents to prioritize and define their top overall risk, and top five systemic risks, as well as provide insight into the perceived level of systemic risk, including what efforts and investments their respective firms are making to develop and enhance their systemic risk mitigation capabilities.

I would also add that, like any survey, it's really just one data point that helps inform our risk management program, and it serves as a springboard to further engagement with our members to get behind the survey responses and really understand what's driving them.

Julia: **With the planned Brexit and turmoil surrounding the US Presidential election this year it is no surprise that the report cites geopolitical risk as a top of the list concern for firms. Now that we have some clarity on what is likely to happen next for both the US and Britain, do you think geopolitical risk will remain a top concern for 2017?**

Mike: I do expect geopolitical risk to remain at elevated levels going forward. While we have decisions on the outcomes of the votes for both Brexit and the US presidential election, the uncertainty, next steps, and the implications that follow both results are still undefined and will start to formalize in the coming months and years to follow.

In terms of Brexit specifically, once the UK triggers Article 50 which Theresa May has indicated should occur by the end of March 2017, the UK will have two years to negotiate their exit from the EU. Only one country has exited the EU since formation, which was Greenland in 1985, and that exit process took about three years. The UK is much more integrated within the EU as global multinational companies utilize their UK offices as an entry point into the EU single market. The financial services industry specifically uses the UK to passport their services within the EU, and therefore firms would need to adjust their operating models if passporting of services was no longer available.

Turning to the US presidential election, a lot of people woke up in surprise following the results as most of the polls were forecasting a different outcome. The majority of forecasting focused on which individuals would fill the cabinet and be appointed positions in the new administration, and what would be the regulatory outlook of the next administration.

The election results however appear to have provided a mandate for the Republican Party to govern through their control and leadership over the US House of Representatives, US Senate and the ability to appoint Supreme Court Justices. Republicans in Congress and President-elect Trump should be able to pass and repeal legislation as well as implement their policies.

Other countries such as Spain and Italy are considering referendums following the result of the Brexit vote and the US presidential election, building on this momentum for change.

So, yes, I do expect that geopolitical risk will remain a top risk for at least the next few years.

Julia: So focusing on geopolitical risk a little bit more, what exactly are the concerns related to this? Is it uncertainty with global or country economies or other possible changes?

Mike: Concerns related to geopolitical risk encompass a broad spectrum and I would say geopolitical risk could be any item or decision that has an impact across country borders and multiple jurisdictions. This could include decisions on trade and global alliances, utilization of government policy to disrupt and impact other countries, policies on global supply levels of national resources, risks associated with migration and movement of people and resources via open or closed borders, sovereign decisions that reflect the nationalist view versus the global view. So, you can see it really encompasses many different types of risks.

Some of the bigger geopolitical risks specifically related to the US election or Brexit were included in separate categories because of their broader implications to the global economy and impact on financial services, including DTCC and its member firms.

Julia: The report mentions regional differences between perceived risks. What were the main differences and what is the reason behind these differences?

Mike: Since inception our Systemic Risk Barometer survey has featured a larger concentration of North American respondents versus those outside North America which reflects the makeup of DTCC's membership base. The most recent survey highlighted that North American respondents were more concerned with cyber risk, liquidity and sudden dislocation in the markets than respondents outside North America.

Inversely, respondents outside North America were more concerned about Brexit, the Asia economic slowdown and the European economic slowdown than their North American counterparts, with the most significant difference being related to Brexit.

For a financial services practitioner in the US, Brexit is somewhat an unknown, with on the ground planning and readiness efforts for the most part being led out of the UK. It is largely due to the fact that the decision will likely not have the same degree of impact on financial services professionals in the US than it will have on those working in Europe or the UK, which explains some of the differences in risk prioritization from the respondents.

For financial services professionals working in the UK or Europe there are immediate concerns about the location of their jobs and function, for example: is this going to lead to a relocation of myself and my family, if so, where? What does the professional development mobility look like after a long period of uncertainty rolls out?

So, that explains some of the key differences between the responses we received from North America or Europe.

Julia: **Cyber risk remains top of this list of risks which isn't surprising given the news of constant website hacks. Has concern over cyber risk increased in the last six months? And do you think this will change in 2017?**

Mike: Cyber risk continues to be the overall top risk, with 22% of respondents identifying it as the top risk. It was actually 25% in the first quarter of 2016, so it did decline slightly.

That said, I do expect cyber risk to remain right near the top if not the top risk going forward.

56% of respondents have identified cyber risk as a top five risk to the broader economy, which is consistent with the response rate in the first quarter of this year. Also, cyber risk has been cited as a top risk in each of the DTCC Barometer surveys since its inception in 2013, which is quite telling.

Cyber risk comments that we received cite the increasing sophistication and frequency of cyber attacks, that cyber risk remains a constant occurrence, and that cyber attacks on key market participants can have broad impact and propagate across financial markets. So those are some of the actual comments that respondents wrote in to the survey which gives a bit of context around their concerns.

Cyber attacks continued against financial services institutions in 2016 despite significant increases in investment focused on cyber risk mitigation across the industry. One of the better known attacks that has occurred recently was the heist of about $81 million dollars from Bangladesh Central Bank. Bitfinex which is the fifth largest Bitcoin exchange was subject to a hack with 65 billion Bitcoins stolen from the exchange. Also, Equador's

Banco del Austro, where hackers targeted and obtained banks' SWIFT codes and initiated unauthorized transfers of $9 million dollars. And those are just a few examples of the many cyber attacks that continue.

Financial services represent the largest non-government concentration of investment and spending in the area of cyber security. And also the financial services industry ranked third in the number of cyber attacks received in 2015, behind only the healthcare and manufacturing industries.

Therefore, we really do expect this to continue to be a top risk and concern for the industry and will likely be decided as such going into 2017 in our future surveys.

Julia: Going back to the report, what was the most surprising finding from this survey?

Mike: Probably the most surprising finding for me was that risks of economic slowdowns across the various locations Asia, US and Europe - that were cited in the Q1 survey of 2016, declined to levels from 12 months ago.

Another item that also surprised me was the degree to which broader geopolitical concerns and risks dominated discussion and survey results, with the US election and geopolitical risk and Brexit all carrying top five risks, as I've mentioned.

I would suspect that some of the changes are due to the timing of the survey. The Q1 survey, for example, was launched in February immediately following the early 2016 volatility that had appeared across markets in China. The Q3 survey was launched in mid-September, following the surprise UK Brexit vote and a tough US presidential election campaign.

So to some extent the timing of the survey may impact the results we get, but those are the surprises that I found from the most recent iteration.

Julia: Final question for you Mike, do you expect a new risk to take top spot in the top five list next year? Do you have any predictions for how the systemic risk barometer may change in the coming year?

Mike: Now that the Q3 barometer survey has been concluded, our team will conduct a post-mortem to evaluate the process and determine any opportunities for continued enhancement in the upcoming versions of the survey.

As we try and ensure that the survey continues to evolve and remain relevant, we're constantly asking for feedback from our members on risks and focus items on their agenda to incorporate back into the survey questions.

During 2016, we added new risks related to Brexit and the US election outcome based on the feedback we received, which is something I would expect to continue in future surveys.

I would expect cyber risk and security to remain near the top of overall risks moving forward and some consistency to be maintained within the top five risks so we continue to show trending over time.

Julia: **Thank you Mike for sharing the results of the Systemic Risk Barometer Report with us today.**

Mike: You're welcome. I enjoyed it, take care now.

Julia: **Listeners you can find more information on this report and also links to recent podcasts and articles on risk management on our podcast notes page found on DerivSource.com**

Thank you for listening. Join us next time.