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Implications for businesses: Banks and financial institutions

Ukraine: A conflict that changed the world

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Lloyd's Futureset

The impact of the crisis on macroeconomic themes will be felt across all industries to varying degrees.

Inflationary pressures associated with supply chain issues, such as costs of materials, labour and logistics are mounting, with companies considering a number of solutions to maintain revenue and profitability. For instance, oil and gas producers and food manufacturers will be the most impacted by inflation, largely due to Russia and Ukraine having dominant positions as major exporters of key raw materials across these industries.

Other industries may need to change business models as a result of subtle changes in trading behaviours. As each nation becomes more focused on developing domestic production to avoid geopolitical risks, transportation and logistics companies will likely need to evolve to accommodate a lower demand for international trade but growing interest in national logistics solutions.

With ESG becoming an increasingly prominent topic on corporates' risk agendas, significant resources are being allocated to dedicated ESG teams across multinational corporations to develop risk management strategies. With increased awareness and potential scrutiny from employees, customers and stakeholders, businesses could incur significant costs to adhere to ESG standards.

In order to meet public expectations, thousands of companies have exited from or paused Russian operations. Those that continue to conduct business in Russia face potential reputational damage in the affected region, which could lead to economic repercussions (for example a. decline in business due to global boycotts). Corporates are also spending significantly more on due diligence and compliance reviews to ensure any direct or indirect relationships with Russia are identified and replaced.

Aon Global Risk Management Survey

Aon's 2021 Global Risk Management Survey illustrates today's traditional and emerging corporate risk portfolio. The Survey collates responses of over 2,300 risk managers from 16 industries, spread across varying territories and company sizes. In 2021 respondents selected and rated 10 top risks that their organizations were facing:

01	Cyber Attacks / Data Breach
02	Business Interruption
03	Economic Slowdown / Slow Recovery
04	Commodity Price Risk / Scarcity of Materials
05	Damage to Reputation / Brand
06	Regulatory / Legislative Changes
07	Pandemic Risk / Health Crises
08	Supply Chain or Distribution Failure
09	Increasing Competition
10	Failure to Innovate / Meet Client Needs

The following analysis breaks down the results of this survey by industry sector and considers how each sector's risk profile has changed as a result of the conflict in Ukraine. Risks highlighted in bold indicate risks that will be further amplified by effects of the crisis.

Overview

The following table summarises the implications of each of the market forces explored in this report to businesses over the short to long term. These are assessed in greater detail over the following pages for the different industry groups expected to be most impacted by the crisis.

	Cyber	Supply chain	Food security	Climate transition	Energy security	ESG	Public sentiment
Banks and financial institutions	Minimal	Minimal	Minimal	Minimal	Minimal	Significant	Medium → Significant
Construction and manufacturing	Minimal	Medium → Significant	Minimal	Minimal	Medium → Significant	Medium	Minimal
Energy	Medium	Significant	Minimal	Significant	Significant	Medium → Minimal	Significant → Medium
Food and beverages	Minimal	Significant	Significant	Minimal	Medium	Minimal	Medium → Minimal
Public sector and healthcare	Significant → Medium	Minimal	Significant → Medium	Significant	Minimal	Minimal	Significant
Technology	Medium → Significant	Minimal	Medium	Medium	Minimal	Minimal	Minimal
Transportation and logistics	Significant → Medium	Minimal	Medium	Medium	Significant → Medium	Minimal	Minimal

Key:
- **Minimal:** Market forces will have no or minimal impact on the industry
- **Medium:** Market forces will have an indirect impact on the industry
- **Significant:** Market forces will have a clear, adverse impact on the industry

Banks and financial institutions

Cyber	Supply chain	Food security	Climate transition	Energy security	ESG	Public sentiment
Minimal	Minimal	Minimal	Minimal	Minimal	Significant	Medium → Significant

Global insurance premium: $138bn

Aon 2021 Top 10 Global Risks
(Risks in **Bold** are likely to be further amplified by effects of the Ukraine crisis):

01	**Cyber Attacks / Data Breach**
02	**Economic Slowdown / Slow Recovery**
03	**Damage to Reputation / Brand**
04	Counterparty Credit Risk
05	**Regulatory / Legislative Changes**
06	**Business Interruption**
07	**Tech Failure / System Failure**
08	Data Privacy Requirements
09	Increasing Competition
10	Failure to Innovate / Meet Client Needs

Banks are facing two key ongoing challenges in light of the conflict – balancing both ESG and profitability goals and reconsidering where business operations ought to continue. However, some opportunities have emerged, such as growing interest in a multi-purpose cryptocurrency market.

Short term: Banks are currently weighing the balance between meeting ESG objectives and maintaining profitable business. Most ESG funds are exposed to technology stocks, which have experienced notable volatility throughout the crisis. "Non-ESG" funds typically contain some exposure to oil and gas markets which has experienced accelerating price increases over the past months. Leading investors such as Warren Buffet have publicised immediate plans to invest more heavily in the energy sector to benefit from market inflation. Amid the crisis, traders have also been left stuck with unsellable Russian shares and bonds, while derivatives linked to them have been left in a state of limbo.

Medium term: Some parts of the banking industry have seen new opportunities emerge due to the conflict. There has been an influx of cryptocurrency in the dark web to enable Ukrainians to trade amongst themselves and with international companies more effectively, supporting Ukrainian conflict efforts, and helping migrants and refugees move money. Digital currencies have also been used for humanitarian purposes – 'techno-natives' have helped the Ukrainian government raise over $100 million in crypto donations. Cryptocurrency could become a more popular alternative for local currencies, especially in areas of conflict.

Banks and financial institutions (continued)

> A significant amount of cryptocurrency was donated to the Ukrainian government since the start of the Russian invasion. This has created an influx of crypto and crypto trades in the dark web... the volatility of the crypto market along with the conversion of fiat currencies into crypto presents a number of key risks
>
> **Head of Financial and Professional Services**

Long term: Beyond ESG implications, banks are having to reconsider business operations. Many leading organisations have looked to relocate servers elsewhere to avoid business interruption, with Dubai becoming an increasingly popular hub for companies such as Goldman Sachs.

Case study: Global bank **JPMorgan** is "actively unwinding" its Russian business despite significant exposures, stating that its decision was both commercial and "the right thing to do from a moral standpoint".

More likely scenarios | Less likely scenarios

01 Defensive push-back	02 Protracted conflict	03 Annexation	04 Collapse of Ukraine	05 Escalation
– Banks may reconsider investment exposures in high-risk regions – Conversely, Russian investments may begin to pick back up as markets in these affected regions stabilise – Payment operators such as Visa resume operations in Russia but limit investments and loans paid to Russian businesses	– Banks seek to maximise on financial market volatility to gain profits, while increasing provision of loans and funding to farmers to ensure citizens are fed	– Firms stick to existing investment strategies including international energy companies – Sustained investment in cyber security despite inflationary pressures – Banks may partner with governments for sustainable financial support such as green bonds – Closure of physical operations in Russia, with many banks relocating hubs to neighbouring regions (e.g. Dubai)	– Banks provide funds only to those organisations providing essential products (e.g. food manufacturers) – Companies expand the block on processing payments to Russian allies, and withhold investments across transport and manufacturing industries in affected regions	– Successful cyber-attacks on financial institutions may lead to short-term economic failure (inability to transact domestically and internationally) – Increased cost to businesses from a risk management perspective and loss of revenue as more criminal behaviour amongst hacktivists is incentivised by governments

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