Non-financial risk management: Emerging stronger after Covid-19

By Thomas Kaiser

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This book is a comprehensive source of knowledge on the timely and broad topic of non-financial risk management (NFRM). Although many considerations in the book refer to risks resulting from COVID-19, which accelerated the role of NFRM (especially in financial institutions), the general approach in the book is much broader.

The book is a collection of 26 chapters, written by 43 people. The editor of this book is Professor Thomas Kaiser, from Goethe University in Frankfurt and an experienced practitioner in risk management.

The chapters of the book are organised into the five following parts:

- the origins of NFRM (5 chapters);
- governance of NFRM (4 chapters);
- tools and instruments for NFRM (6 chapters);
- focus areas of NFRM (7 chapters); and
- the future of NFRM (4 chapters).

The most important takeaways (among many) for anyone who would like to analyse NFRM based on theoretical insights or to manage this risk in practice are as follows:

1. The debate about the definition of non-financial risk is ongoing. Some researchers see non-financial risk as all types of risk not included in classical financial risk (containing market and credit risk). Others, however, assert that non-financial risks include operational, reputational and climate risks, etc. This list may be endless, given the emergence of new types of risk, like pandemic risk, environmental, social and governance (ESG) risk, etc.
2. Despite the name 'non-financial', all risks in this category have financial consequences regarding losses. These losses are significant in extreme events (low frequency, high severity).
3. There is a strong need for integrating all types of risk (financial and non-financial) in the organisation rather than looking at them in silos.
4. The quantitative tools for NFRM are not as well developed as they are for market risk and credit risk, partly because it is challenging to quantify them. Classical approaches, however, such as scenario analysis and stress testing are widely recommended. The success of quantitative tools depends on the appropriate combination of data and models.
5. Non-financial risks are very diverse. Therefore, NFRM should integrate different methods developed for heterogeneous types of data.
6. Governance is a crucial part of NFRM. Financial institutions may adopt many existing governance solutions developed in enterprise risk management (for example, three lines of defence) for non-financial companies that may have greater experience of managing non-financial risks. These solutions include risk culture, one of the most crucial elements for successful NFRM.
7. Risk management is conducted by humans. Therefore, cognitive and emotional biases impact the performance of risk management.
8. The future of NFRM will depend on the effective combination of human judgment and digital tools.

There are several benefits to the readers of this book. First, it is directed towards a broad audience, including practitioners (working in companies and financial institutions), researchers, students and newcomers. Secondly, some parts of the book can be read separately, including Part 2, describing governance problems, and Part 3, covering analytical tools. Thirdly, the book has comprehensive coverage and a lot of good practices for risk managers taken from several organisations.

For future editions of this book, it would be beneficial to add more text on the following issues because of the growing impact on an organisation's risk:

- ESG risk;
- cyber risk;
- media (and social media) risk — a lot of media goes viral by providing fake news;
- technology risk resulting from the use of non-transparent and non-professional algorithms.

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