Typical failures in bank risk management

Agenda

- Typical determinants of bank distress
- Risk typology
- Is (was) this time different?
- What’s new?
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Distressed vs. non-distressed banks
Liquidity - liquid assets to funding

Capital adequacy – equity to assets
Profitability - ROA

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Basel capital regulations – pillar I

- Credit risk
- Market risk
- Operational risk

Basel capital regulations – pillar II – other material risks

- Interest rate risk (in the banking book)
- Liquidity risk (+ separate regulations on LCR and NSFR)
- Excessive leverage
- Credit concentration risk
- Reputational risk
- Model risk
- ...

...
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Credit risk (1)

- Excessive risk appetite (for any type of risk)
- Too liberal credit policies (cut-off rates/ratings)
- Too ambitious targets in sales plans
- Bad pricing policy -> too low margins
- „Connected” lending
- NPL vs. NPE
Credit risk (2)

- PD - probability of default
  Actual PDs higher than historical (expected)
- LGD - loss given default
  Actual LGDs higher than historical (expected)
- CVaR – credit value at risk
  How to estimate CVaR close to reality?

Market risk (1)

- VaR – risk underestimated due to too many tail events
- sVaR (stressed VaR)
- cVaR (conditional VaR) = expected shortfall (ES)
Market risk (2)

Operational risk

- Frauds (internal and external)
- Improper internal processes
- Misseling
Pillar II failures

- Improper selection of material risks
- Underestimation of risk
- Too relaxed stress tests

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Challenges for risk management

- Cyber-security
- Exposures to shadow banking
- Robots
- Reputational risk

Thank you for your attention!

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