

Risk Management in Banks & the Capital Implications

A two-day workshop to give a better understanding of the key risks faced by banks and how these risks are addressed by regulators under Basel II & Basel III, and internal economic capital models. An overview of lessons learned and best practice in the identification, monitoring and management of risk.

TARGET AUDIENCE

Bankers, internal auditors, regulators and analysts but is also appropriate for a broader audience who wish to gain insight into the risk management process and how capital is allocated. The course is targeted at an intermediate level and assumes a basic understanding of banking products.

COURSE OBJECTIVES

Understand how risks are categorised, quantified, monitored and managed within banks.

Specifically, participants will be equipped to:

- Identify, categorise and quantify credit, market, liquidity, operational, legal, regulatory and reputation risks
- Understand the systems and procedures needed to track, monitor and manage these risks
- Have an understanding of how the banks capital is allocated to each of these risks from both a regulatory and management perspective.

CONTENT

ANALYTIC OVERVIEW

The aim of this section is to introduce the inherent risks of a bank's balance sheet and the need for capital to cover these risks

Overview

- Why risk is inherent to a banks business model and therefore why effective risk management is critical
- An overview of lessons learned from risk management failures and best practice in the identification, monitoring and management of the different risks faced by a bank
- Value drivers and business model of a bank
- Differing perspectives: shareholders, regulators, debt providers.

Risk Management

- Identifying and defining major risk groups: credit, market, liquidity, operational, legal, regulatory, and reputation
- Significance of risk groups for different banking businesses
- Inter-relationship between key risk groups
- Management objectives – risk vs. return
- Lessons learned from recent risk management failures.

Capital Allocation

- Definition of capital: expected and unexpected losses
- Types of capital: shareholder, regulatory and economic capital
- Regulatory capital:
 - Definitions of Regulatory Capital; Core Capital, Tier 1/2
 - Structure of the Basel capital adequacy model:
 - Basel II Structure: Pillars I, II and III
- Economic capital and Economic Value Added (EVA)
 - Key assumptions, benefits and shortcomings
 - How management can use economic capital in the business
- Managing capital structures: comparisons between banks.

Case study/exercise: Contrasting definitions of capital for a large international bank.

MARKET RISK

This section introduces sources of market risk in the balance sheet

and how this risk can be quantified and managed. Finally the section covers the principles of regulatory capital allocation for market risk.

Identifying and quantifying the risk

- Defining market risk
 - Types of market risk and relation to products
- Trading Book vs. Banking Book
- Value at Risk (VaR):
 - Key concepts: holding periods, confidence levels, disclosure
 - The basic VaR calculation
 - Limitations to VaR
- Complementary risk measures:
 - Stress testing and simulation modelling
 - Limit structures in the dealing room
- Market risk in the banking book
 - How it arises and accounting impact
 - Measurement using VaR and simulation techniques
- Fair Value Pricing Hierarchy and the inherent risks of mark to model valuation
- Comparative analysis of market risk disclosures
- Capital treatment of market risk under Basel II.

Case study: Market risk in an investment bank

CREDIT RISK

Credit risk is possibly the most important risk faced by most commercial banks. This section aims to identify the different sources of credit risk within a banks balance sheet, how these risks can be managed, mitigated against and quantified. The section concludes with a study of the treatment of credit risk for regulatory capital from Basel I through to Basel III.

Identifying and quantifying the risk

- Importance of credit risk and relation to other risks
- Categories of credit risk:
 - Risk types: lending, issuer, contingent, pre-settlement, settlement, transfer / country risk
 - Methodologies for quantifying the exposures (particularly pre-settlement risk).

Managing credit risk

- Limits and safeguards – policy, process and procedures
- Credit approval authorities and transaction approval process
- Aggregating exposure limits by customer, sector, correlations
- Credit mitigation techniques: collateral; termination clauses, re-set clauses, cash settlement, netting agreements
 - Applications and risks of mitigation: wrong way trades
 - Documentation: covenants, ISDA / CSA and other collateral
- Credit portfolio management techniques: syndication, sub-participation, whole loan sales, credit derivatives, securitisation
- Fundamentals of credit risk capital measurement: probability of default, exposure, loss given default and correlation
- Capital treatment of credit risk under Basel I and II and III.
- Standardised approach
 - Foundation and advanced internal ratings based approaches
 - Recognition of Credit mitigation techniques
 - Regulatory capital treatment for derivatives

Case study: Credit risk portfolios and hedging in a large international bank



OPERATIONAL RISK

Operational risk was a new risk to be quantified under Basel II, and occurs throughout a banks business model. This section aims to explore some of the challenges that face banks in controlling, quantifying and allocating regulatory capital to operational risk.

Identifying, defining and quantifying the risk

- Sources of operational risk; systems, people procedures and external events
- Reasons for banks to control operational risk; legal requirements, regulatory and management
- Examples of operational risk failures in financial institutions
- Best practice systems and management procedures
 - Loss distribution approach
 - Scenario Analysis
 - Extreme Value Theory
- Internal Risk Assessments
- Statistical challenge of high value, low frequency losses
- Regulatory Capital requirements for operational risk
 - Basic indicator approach
 - Standardised Approach
 - Advanced Management Approach
- Importance of culture in controlling operational risk
- Regulatory standards for internal systems under the advanced management approach.

LEGAL, REGULATORY, REPUTATION RISK

This section addresses some of the common risks discussed by banks in their annual reporting. These risks are often described as softer risks due to the fact that they are not required to be quantified under Basel 2 or 3. This does not make them less important, indeed reputation is one of the most important risks for a bank to manage.

Identifying, defining and quantifying the risk

- Definition of Risks
- Distinction of true legal risk from legal operational risk and its management
- Impact of changing regulations on banks
- Sources of reputational risk and relationship to other risk groups
- Corporate governance culture and their role in managing reputational risks.

Case study: Reputational risk and efforts to repair through cultural reform

LIQUIDITY RISK

Liquidity risk can be the most acute form of risk facing a financial institution at times of crisis as this is often the means by which providers of bank funding express dissatisfaction with management of other risks (e.g. credit risk). The aim of this section is to explore types of liquidity risk, how these risks are managed and concepts of regulatory supervision.

Identifying, defining and quantifying the risk

- Types of liquidity risk: funding and transactional
- The elements, objectives and importance of a funding strategy
- How liquidity risk affects different types financial institutions
- Historic liquidity problems in banks
- Lessons learned from the financial crisis in liquidity risk management; Off-balance sheet contingencies, complexity, collateral valuation, intra-day liquidity risks and cross-border liquidity
- Gap management: interest, currency, and maturity mismatches
- Challenges of measuring and comparing liquidity
- Concepts of cash capital.

Managing liquidity risk

- Asset and liability management techniques: gap limits
- Regulatory requirements and proposed Basel changes
 - Pillar two requirements
 - Principles for liquidity risk management
 - Early warning indicators of liquidity risk
 - Liquidity coverage ratio
 - Net stable funding ratio
- Measuring and managing stress scenarios: elements of a contingency plan.

Case study: Liquidity Risk in an investment bank.

Learning Paths

