

Risk Management for Banking

What is risk?

Danger that a certain unpredictable contingency can occur, which generates randomness in cash flow .



- Risk and uncertainty – risks may be described using probability analysis (business cycle, company failures), while events subject to uncertainty cannot (financial crises, wars etc.)

Main forms of risk

Credit risk

- risk that party to contract fails to fully discharge terms of contract

Interest rate risk

- risk deriving from variation of market prices owing to interest rate change

Market risk

- more general term for risk of market price shifts

Liquidity risk

- risk asset owner unable to recover full value of asset when sold (or for borrower, credit not rolled over)

Market liquidity risk

- risk that a traded asset market may vary in liquidity of the claims traded

Other risks

- o operational risk
- o risk of fraud
- o reputation risk

Systemic risk – that the financial system may undergo contagious failure following other forms of shock/risk

Risks in secured lending - particular reference to real estate

Why do banks overland to real estate?

- - alternatives?
- - Collateral
- - Balance sheet growth

Issues

- - externalities of lending severe
- - potential “disaster myopia”
- - vulnerability to macroeconomic
- shocks

Example of the consequences - Swedish banking crisis

- Financial liberalisation – banks and authorities unfamiliar with liberalised regime
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- Growth in bank lending (140% 1985-90) and private sector debt, particular focus on real estate lending, encouraged by tax deductibility
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- Market share competition among banks
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- Shocks - global recession, high interest rates to hold exchange rate, tax reform abolishing interest deductibility
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- Majority of banks insolvent, non performing assets 14% of GDP
- Cost of public rescue 4.5% of GDP

Risk Management



- Risk management system structure of BTA Bank JSC as one of the main components of corporate governance is focused on minimizing influence of any risk to the corporate financial status and its ability to perform assumed liabilities. BTA Bank JSC monitors and controls its risks in compliance with the main ethical principles and limits approved by the Board of Directors. The Board of Directors determines medium- and long-term strategies and supervises Company's operations. Management Board, Risk and Asset and Liabilities Management Committee of the Board of Directors and other bodies responsible for risk management in due term submit reports on Company's performance, information on risks and financial status for consideration and approval by the Board of Directors.

- Delegation of responsibility and liabilities between supervising and executive bodies in BTA Bank JSC is based on the principles of corporate governance in order to monitor and control the following risks related to banking activities:

- *Credit risk;*
- *Country risk;*
- *Market risk, including currency, interest and price risks;*
- *Liquidity loss risk;*
- *Operational risk;*
- *Compliance risk;*
- *Legal risk;*
- *Business reputation loss risk*

