Turbulence in Financial Markets – Impact on Risk Management

What urgent actions should CRO's and Risk teams be taking?

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Over the past few weeks, global central banks and regulators have put in a number of backstops and other measures in an effort to calm markets. Despite these measures, markets have remained jittery, potentially indicating that the worst isn't over yet. This mini-crisis has been accelerated by social media which may have spooked customers and exasperated their deposit withdrawals using mobile apps. As a consequence, both insured and uninsured deposits have been put into the regulatory spotlight.

The unexpected crisis also raises questions about some banks' existing risk management frameworks in terms of their effectiveness and agility. Given all these developments, risk teams may want to consider the following key action points.

Recommended Short Term Actions

01 Liquidity Assessment

Conduct real-time liquidity analysis – i.e. a worst-case-situation analysis updating liquidity forecasts taking into account repercussions due to funds looking for safe havens as well as market impacts on liquid asset values.

Are we safe enough?

02 Portfolio Reviews

Review direct and indirect exposure to less stable sovereigns as well as to FI's and NBFI's. Review second order exposures - i.e. clients or counterparties that may have exposure to institutions that are showing signs of distress and material correlation to AT1 assets.

Do we need to take action?

03 Valuation Check

Review exposure to duration risk. Confirm valuation of financial instruments, VaR limits, breaches, collateral, equity & bond positions, AT1 instruments, derivative, and hedging positions.

Are we confident in our numbers?

04 Stress Testing

Conduct near daily capital & liquidity stress tests using historical and current data factoring in large and rapid rises in interest rates and bank run scenarios.

Are there any other outliers in the system and what actions should be taken?

05 Global Limits Review

Conduct urgent review on sector limits and assess if any mitigating actions are needed with regards to limit setting across FI's and NBFI's and other counterparties.

Have we been dynamic enough with adjusting our limits?

06 Reputation Risk

Urgently assess impacts of recent turmoil on reputation risk. Review holdings of products like such as CoCo and AT1 bonds to access our risk. **Are we comfortable with our sales suitability process? Do we need to review previous sales for risk of mis-selling of products?**

The recent market volatility is likely to have a prolonged impact and financial institutions will need to look at potentially strengthening their risk management frameworks over the longer term. We suggest some medium- to long-term actions banks can take to buttress risk management and incorporate lessons from the recent turmoil.

Recommended Medium & Long Term Actions

Asset & Liability Management (ALM)

Deep-dive review on the ALM framework, balance sheet composition, models, stress tests, and assumptions applied for Interest Rate Risk Management (IRRBB) & Liquidity Risk Management across the bank.

Credit Risk Management Review

Deep-dive review on the framework for managing credit risk exposures to banks and NBFIs, covering counterparty credit risk, limits, credit ratings, risk appetite setting, early warning indicators such as CDS spreads, among others.

Stress Testing Framework

Validation and review of the stress testing assumptions, models, scenarios in place. Verify if scenarios and methodology are fit for purpose given recent volatility including credit and liquidity stress tests on balance sheet & PL.

FI & NBFI Credit Policy Refresh

Review all credit policies covering FIs & NBFIs. Refresh the policies to include concentration and correlation metrics, real-time EWIs, remediate gaps, update limit frameworks, refresh new product approvals, credit risk assessments and CCR frameworks.

Technology & Network Analysis

Conduct a review and study on network analysis applications and tools available to support the bank with a more dynamic approach on early warning indicators to support dynamic risk management.

KPMG has tools, templates, and experts that can help with all of these actions.

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