ATMOSPHERICS

05.19.23

RISK MANAGEMENT

Bottom Line Up Front:

- The financial crises of the late 20th and early 21st centuries, such as the Savings and Loan Crisis (1980s), the Dot-com Bubble (late 1990s), and the Global Financial Crisis (2008), prompted regulatory bodies to adopt a more robust and proactive approach to risk management - all while their effectiveness in protecting against fragility remains to be seen.
- Risks for financial institutions can be financial, such as balance sheets, financial investing, and expenditures, or non-financial, such as bank operations, environmental conditions, and social perceptions. Many of these non-financial risks bleed into other industries and companies outside of the financial sector.
- Generative AI is already making its mark within the risk management approaches taken by financial institutions via fielding automated data analysis to detect suspicious communications and behavior (which for example, may be tied to insider trading) in a fraction of the time it'd take a human to do the same thing.
- A less-obvious area of risk management, which is of particular importance right now, is how global financial institutions account for evolving geopolitical risks. Today more organizations than ever have access to geopolitical "information", but the appetite for *context* is growing.

INFORMATION

Blue terms are connected to the word of the week via news outlets and searches, whereas black and gray terms are not directly related, but still dominate the social space.

Risk Management defined: For purposes of this week, our focus on risk management is mostly centered on its role related to financial institutions and the economy. In this context, risk management is defined as the process of identifying, assessing, and controlling risk tied to localized issues (e.g., a company's balance sheet) as well as systemic issues (e.g., the 'balance sheet' of the industry, and the potential contagion during a time of crisis). As this definition suggests, an almost-inseparable point to be made here is the role public policy plays with financial institutions' approach to risk management, and the impact it can have on an outcome (desired or not).

Why this topic is important right now: With everything that's been unfolding within the financial markets over the last 6+ months topics related to risk management have emerged at a higher rate than usual, so has the severity of their implications. Today's economic, financial, and technological environments are causing a convergence of topics such as, bank collapses, monetary policy, interest rates risks, generative AI automating data analysis, global push against "greenwashing" (think deceitful ESG), and even a growing appetite for geopolitical advice. As recent as this week, a slew of articles and opinions have resurfaced the debate over corporate vs regulatory responsibilities tied to deposit guarantees, required liquidity ratios, and enforcement/accountability during tumultuous times of market-panic and bank runs. As more people become aware of the interaction between these topics, the extent of the contagion mentioned earlier will become clearer, and the impact on stakeholder sentiment will undoubtedly be felt.

TECHNOLOGY

AI Generated Image

"Risk management for financial institutions is like building a solid foundation amidst a changing landscape. It's the art of balancing opportunity and prudence, empowering institutions to confidently navigate uncertainties while safeguarding their core objectives and stakeholder trust."

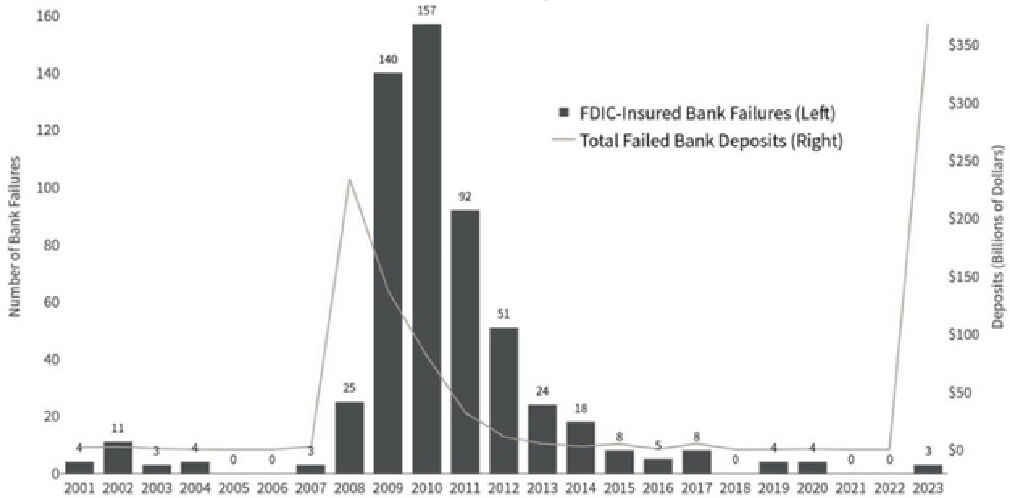
-ChatGPT, 2023

Risk management is of paramount importance for financial institutions to navigate uncertainties and safeguard their financial health, stability, and reputation. Inadequate risk management practices can expose institutions to a range of dangers with severe consequences. Improper risk management can lead to significant financial losses, impair profitability, and weaken the institution's financial position. It can also result in reputational damage, loss of stakeholder confidence, and difficulties in attracting customers and capital.

To mitigate these dangers, financial institutions must employ robust risk management strategies. They should conduct comprehensive risk assessments, continuously monitor market conditions, and establish strong risk governance frameworks. Diversification, stress testing, and risk mitigation techniques are essential to manage internal risks such as credit, market, liquidity, operational, compliance, and reputational risks. Additionally, institutions must stay informed about regulatory changes, diversify investments, manage counterparty risks, and develop business continuity plans to address external risks. Examples of external risks include economic downturns, regulatory changes, market volatility, cybersecurity threats, and geopolitical events.

Financial institutions typically adopt a risk-averse stance during uncertain times, taking preventive and defensive measures. By prioritizing sound risk management practices, financial institutions can enhance their resilience, protect their reputation, comply with regulations, and navigate uncertainties successfully. Robust risk management enables institutions to proactively identify, assess, and mitigate risks, thereby ensuring their long-term viability and contributing to their overall stability and success.

SENTIMENT



FDIC Number of Bank Failures and Total Deposits of Failed Banks Since 2001

Source: Clearnomics FDIC 2023

The level of understanding among the general public regarding the intricacies of risk management in financial institutions can vary. While some individuals may have a basic understanding of risk management concepts, others may have limited knowledge or may not be familiar with the details of risk management practices in financial institutions.

Public opinion on failed banks can vary depending on several factors, including the scale and impact of the failures, the economic climate, the circumstances surrounding the failures, and the effectiveness of the regulatory response. In general, the public's perception of failed banks can be influenced by factors such as:

Economic Impact: If the failures of banks have significant repercussions on the broader economy, including job losses, market instability, or disruptions to financial services, it could lead to negative public sentiment and concerns about the stability of the financial system.

Trust and Confidence: Bank failures can erode public trust and confidence in the banking sector. If the failures are perceived as a result of mismanagement, unethical practices, or inadequate regulatory oversight, it may generate public outrage and calls for stricter regulations and accountability.

Perception of Government Response: The public's opinion may also be influenced by the perceived effectiveness and transparency of the government's response to the bank failures. Public sentiment can be shaped by the government's actions to protect depositors, address systemic risks, and hold responsible parties accountable.

Media Coverage and Public Discourse: Media coverage plays a significant role in shaping public opinion. The tone and framing of news stories, analysis, and public discourse surrounding failed banks can influence how the public perceives the events and the institutions involved.

It's important to note that public opinion can be diverse and complex, as people may have different perspectives based on their personal experiences, economic circumstances, and knowledge of the banking industry.

INFORMATION:

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3. Financial Times. (2023). Special Report Risk Management: Financial Institutions. Retrieved from Financial Times: https://www.ft.com/reports/risk-management-financial-institutions
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TECHNOLOGY:

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2. Neeva. (2023). [NeevaAI response to prompts about risk management].
3. OpenAI. (2023). [ChatGPT response to prompts about risk management].
4. YouChat. (2023). [YouChat response to prompts about risk management].
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SENTIMENT:

1. Multiple social platforms and proprietary listening tools.
2. Clearnomics FDIC (2023)

NEPTUNE

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