

*Research Paper*

The Largest Risks Facing the International Banking System

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ABSTRACT

This paper considers significant risks being faced by the international banking system. Those risks can be clustered into four categories relating to (1) funding and liquidity, (2) regulatory changes (3) cyber security and other geopolitical risks, and (4) the general economic picture. While each of them is considered to be manageable, together they represent a clear and present danger to the international banking system. Therefore, to confront these risks, it is suggested to provide a more systemic solution rather than a separate one. There is a call for a global financial supervision and regulations to deal with these risks. Although the present economic environment looks quite favourable, these risks make it even more important that the international banking system build on the substantial progress already made in strengthening risk management and the resilience of critical market infrastructure. These risks are analysed and recommendations are provided as to how the international banking system might manage them.

Key words: International Banking, Risk, Risk Management.

1.0 INTRODUCTION

Globalization¹ and the big exposure to improbable situations increased risk for financial institutions around the world and developed unimagined difficulties (Hu et al., 2012). The trend toward increased international trade and increased economic ties between countries has opened up international markets for goods, services, investments and financial assets (Hendry, 2011). These cross-border opportunities have increased cross-border financial flows with a concomitant increase in banking transactions (Smistad, 2011).

The international banking industry has undergone tremendous transformation across all markets over the past few years (Lartey, 2012). Recent competition in the

banking industry has compelled many commercial banks to pursue growth in sectors that traditionally fell within the domain of other financial institutions such as investment banks, insurance companies, hedge funds and pension funds (Lartey, 2012). But as argued by Dailami, et al. (2007), every investment and financing decision involving the allocation of resources under uncertain conditions is associated with some form of risk, which is in effect, either assumed in the expectation of a higher return, or is transferred to others through hedging² and/or contracting arrangements.

The recent global financial crisis, rising volatility in the financial markets, increasing deregulation, poor management

¹ The tendency of investment funds and businesses to move beyond domestic and national markets to other markets around the globe, thereby increasing the interconnectedness of different markets (Hu et al., 2012)

² Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract (Dailami, et al., 2007).

practices at banks and other financial institutions, speculative transactions, huge financial losses, introduction of innovative financial products and their growing complexity are some of the current challenges faced by the international banking system (Sethi, Sahoo & Sucharita, 2013). These factors have pushed financial risk management to the forefront by giving new direction (Sethi, Sahoo & Sucharita, 2013).

The consequences of the recent crisis were dramatic for the financial system, as many banks and credit institutions collapsed by the contagious phenomenon (Siskos, 2013). For example, more than 160 U.S. banks failed in 2008 and 2009, while only 11 banks failed between 2003 and 2007 (FDIC, 2011, as cited in Siskos, 2013), resulting in the establishment of a new U.S. federal agency, the Financial Stability Oversight Council, charged with monitoring and mitigating risk in the financial system to avoid future consequences (Hu et al., 2012). In their study, Boyd, et al. (2009) found that all banks are identical in nature and exposed to the same form of risks. It is against this backdrop that this paper attempts to find out the largest risks facing the international banking system. The remaining part of this paper is organised as follows: Section 2 presents reviews of relevant empirical literature; Section 3 presents analysis of facts and issues; Section 4 concludes; and Section 5 provides recommendations.

LITERATURE REVIEW

There is concern that international banking system is becoming more risky, at least in a systemic sense where financial sector shocks might disrupt the entire financial system and impact the broader macro economy (BIS, 2001; Geithner, 2004; Rajan, 2005). De Bandt and Hartmann (2002) offer a useful framework for discussing systemic risk³ and identify two distinct channels – a “narrow” one that

reflects contagion as an adverse shock propagates through the system and a “broad” one where shocks simultaneously affect a large number of institutions.

The questions of systemic risk and common exposures are clearly of enormous importance for regulators, industry participants and investors, and there is some sentiment that the U.S. financial sector is indeed becoming more vulnerable to systemic risk (Geithner, 2004). Rajan (2005), for example, argues that compensation schemes at many financial firms may induce hedging behaviour as managers seek insurance against underperforming their peers. This type of common exposure may increase the possibility of a severe tail event, particularly if exacerbated by liquidity and informational frictions. Empirically, Houston and Stiroh (2006) show that actual volatility⁴ for commercial banks have indeed risen and that this reflects a growing importance of common industry-level shocks.

Schuermann and Stiroh (2006)’s point of departure is the familiar capital asset pricing model (CAPM), which allows a simple decomposition of total variation of returns (a standard measure of risk) into a common, systematic portion and a firm - specific, idiosyncratic⁵ component. Schuermann and Stiroh (2006) expand this single-factor framework to include a range of additional risk factors, for example, the familiar Fama-French factors, interest rate, credit risk, liquidity, and overall volatility measures, and then compares significance, explanatory power, stability, and impact on the systematic/idiosyncratic decomposition across the models. Their goal is not to develop an accurate asset pricing model, but rather to make use of existing standard

³ The risk inherent to the entire market or an entire market segment, undiversifiable risk.

⁴ A measure for variation of price of a financial instrument over time (Houston & Stiroh, 2006).

⁵ Risk of price change due to the unique circumstances of a specific security, as opposed to the overall market. This risk can be virtually eliminated from a portfolio through diversification

models and evaluate their relative usefulness for commercial banks.

Accurately disentangling systematic and idiosyncratic factors is critical from a variety of perspectives (Schuermann & Stroh, 2006). Correlation of risks has implications for the stability of the financial sector and the macro economy via systemic risk concerns, and this necessarily reflects systematic factors because idiosyncratic risk, by definition, is (or ought to be) cross-sectionally independent (Schuermann & Stroh, 2006). This, of course, is true only if one can identify and capture all common factors, so conditional independence may be a distant goal empirically. There are also clear portfolio choice implications as the degree of return correlation has a direct impact on optimal portfolio⁶ strategies (Schuermann & Stroh, 2006). Filtering out dependence by conditioning on observable common factors is critical for risk management, especially credit risk management, as most models presume borrower returns to be conditionally independent (Lando, 2004). Indeed, Das, Duffie, Kapadia and Saita (2006) argue that conditioning on the typical observed factors is not enough to explain observed default clustering, and they propose the inclusion of a latent factor via a frailty model.

Kaen (2005) has defined financial risk as the variability in cash flows and market values which is caused by unpredictable changes in three major variables such as; commodity prices, interest rates and exchange rates. He has described that accurate identification and management of the financial risks will help a firm to reduce the exposure to financial risk. Similar studies by Bartram et al. (2007) have developed three different methods to quantify the risks of a systematic failure in the global banking system. They have taken a sample of 334 banks (representing 80% of

global bank equity) in 28 countries around five global financial crises. Their results become statistically significant, but economically small. They explained that although policy responses are endogenous, the low estimated probabilities suggest that the distress of central bankers, regulators and politicians about the procedures could be overstated and the current policy responses to financial crises could be adequate to handle major macroeconomic events. Daianu and Lungu (2008) have examined the factors which are directly responsible for the exposure in the financial market transactions and indirectly contributed to the current financial crisis. These factors include introduction of innovative financial products and their growing complexity; inappropriate regulation and supervision of financial markets; poor risk management practices at banks and other financial institutions; increased complexity of financial systems; and financial market speculation. These findings are consistent with Sethi, Sahoo and Sucharita (2013).

Stulz (2008) has identified five major factors which are responsible for the failure of risk management systems particularly before and during the current financial crisis. These factors are (1) failure to use appropriate risk metrics; (2) mis-measurement of known risks; (3) failure to take known risks into account; (4) failure in communicating risks to top management; and (5) failure in monitoring and managing risks. Both Stulz (2008) and Daianu and Lungu (2008) have suggested that there is a need to improve the Integrated Risk Management (IRM) technique which is used as one of the risk management processes where all the risks are assembled in a strategic and coordinated framework.

Hassan (2009) has evaluated the degree to which the Islamic banks in Brunei Darussalam implemented risk management practices and analyse how they operate by using different techniques to deal with various kinds of risks. The major risks that were faced by these banks were foreign

⁶ The optimal portfolio concept falls under the modern portfolio theory. The theory assumes (among other things) that investors fanatically try to minimize risk while striving for the highest return possible (see Markowitz, 1952).

exchange risk⁷, credit risk⁸ and operating risk⁹ (Hassan, 2009). It is in a similar disposition that the next section of this paper attempts to find out the largest risks facing the international banking system.

3.0 ANALYSIS OF FACTS AND ISSUES

The global financial system suffered a profound and traumatic shock in September 2008 when US investment bank Lehman Brothers¹⁰ collapsed, Chartered Institute of Management Accountants (CIMA, 2010). As market players withdrew from the financial system, credit dried up and world trade collapsed, there was a real and immediate fear that the world was heading for a repeat of the Great Depression of the 1930s (CIMA, 2010). Two years on and there is growing optimism that both the world economy and the banking industry are recovering from the impact of the financial crisis. But it is equally clear that the international banking system still has to overcome many challenges which are separated into various categories and levels of risk. Those risks can be clustered into four categories relating to (1) funding and liquidity, (2) regulatory changes (3) cyber security and other geopolitical risks, and (4) the general economic picture.

3.1 Funding and Liquidity

Bank funding, liquidity, and collateral management remain a concern, Bank Governance Leadership Network (BGLN, 2012). Much effort has been expended globally to decrease systemic risk in banking by enhancing capital and liquidity requirements, for example, Basel III which covers bank capital, liquidity and

related matters (Scott-Quinn, 2012, p.389). These measures themselves are among the reasons that funding and liquidity remain near or at the top of many risk officers' and directors' risk lists (BGLN, 2012).

Through the coordinated efforts of the Basel Committee and individual countries' changes to capital and liquidity standards, banks' capital and liquidity positions have improved significantly from 2008-2009 (BGLN, 2012). This has reduced systemic risks, though by how much remains a point of argument. Meanwhile, market confidence remains fragile (Protiviti, 2013), and three risks in particular according to BGLN (2012) are culpable:

- **Funding shortages when new capital is required**

The ability of the financial system to fund it the longer the crisis continues, combined with more and more stringent rules on funding, is a risk. Solvency II may curtail insurers' appetite for bank debt and force insurers to raise new capital at the same time that banks need to in order to implement Basel III¹¹ (BGLN, 2012). Other sources of funding are also in doubt. What happens to European banks' balance sheets if US money market funds stay away from European banks? This poses a serious risk to the European banking system.

- **The continuing liquidity challenge**

Who is the provider of liquidity?¹² Liquidity risk management is an art and an integral part of capital planning. As a result of the role the European Central Bank (ECB) and national central banks have played providing market liquidity, risk is being transferred to central banks, and with Solvency II and Basel III, financial institutions cannot take that risk back (Protiviti, 2013). The central banks are faced with a very dangerous systemic risk if something happens. Many remain concerned that the ECB won't act as the

⁷ The risk of an investment's value changing due to changes in currency exchange rates (Hassan, 2009).

⁸ The risk that a borrower will default on any type of debt by failing to make required payments (BIS, 2000).

⁹ A form of risk that summarizes the risks a company or firm undertakes when it attempts to operate within a given field or industry (Hassan, 2009).

¹⁰ Financial services firm Lehman Brothers filed for Chapter 11 bankruptcy protection on September 15, 2008. The filing remains the largest bankruptcy filing in U.S. history, with Lehman holding over \$600 billion in assets (Marketwatch, 2008).

¹¹ A global, voluntary regulatory standard on bank capital adequacy, stress testing and liquidity risk.

¹² A measure of the ability of a debtor to pay their debts as and when they fall due (Protiviti, 2013).

lender of last resort even though that is “the whole rationale behind having a central bank” (BGLN, 2012).

- **Collateral management as a result of ratings triggers**

Political talk about denying future bailouts of large financial institutions could be exacerbating this issue. Ratings agencies used to give a step up to banks’ ratings because of governments as the lender of last resort (BGLN, 2012). Now, governments are saying they will not bail out financial institutions (BGLN, 2012), so ratings will get reduced even if governments will ultimately bail out financial institutions. There are therefore potential consequences of downgrades. If a number of banks are downgraded, collateral demands could be material. There will be a tremendous pull on bank treasuries.

In early January 2013, as many were expecting, the Basel Committee postponed the worldwide deadline for adopting the Basel III capital requirements. The good news is that financial services companies now have more time to prepare to comply with the Liquidity Coverage Ratio (LCR) standards (Protiviti, 2013). However, with the many other financial regulations coming in these jurisdictions including a number of new regulations for U.S. financial services organisations, the delay likely will offer precious little reprieve for these companies (Protiviti, 2013). The coming year will still require them to devote significant time and effort towards establishing long-term profitability and liquidity/solvency given the capital requirements that will phase in March 2019.¹³ They will need to implement a broad range of processes and procedures to ensure they have appropriate and compliant data management and reporting in place, along with supporting infrastructure and capital processes to

¹³ It was agreed upon by the members of the Basel Committee on Banking Supervision in 2010-11, and was scheduled to be introduced from 2013 until 2015; however, changes from 1 April 2013 extended implementation until 31 March 2018 and again extended to 31 March 2019 (Basel Committee on Banking Supervision, 2010)

execute the capital plan and report according to the pending Basel III requirements.

3. 2 Regulatory Changes

Regulatory changes around the globe are introducing new strategic, operational, and potentially systemic risks (BGLN, 2012). During two days of discussion on 15 February 2012 in New York and 29 February 2012 in London, participants in the Bank Governance Leadership Network (BGLN) highlighted several concerns: (1) the consequences of uncoordinated and insufficiently analysed changes in regulation and supervision, (2) new systemic risks arising from regulation, (3) the impact on bank business models, risk profiles, and resultant bubbles, and (4) enhanced consumer protection and associated litigation risks (BGLN, 2012).

- **Consequences of uncoordinated and insufficiently analysed changes in regulation and Supervision**

The scope and intensity of industry regulation have increased to an unprecedented degree following the financial crisis. The advent of Basel III, Solvency II, Dodd-Frank, the Volcker Rule, and the Consumer Financial Protection Bureau (CFPB), along with the actions of the European Banking Authority (EBA), the Independent Commission on Banking, and national supervisors have resulted in a tsunami of regulations for banks and their boards to handle (BGLN, 2012). Compounding the difficulty is the fact that many of the regulations and their implementation are as yet unsettled. Most participants acknowledged that a revamp and expansion of regulation and supervision was necessary coming out of the financial crisis, and the capital and liquidity levels of individual banks have improved as a result. However, since the amount of regulation has increased and coordination among supervisors has been less than complete, attention should rather be centred on the potential for unintended consequences and the effects of all the regulations in aggregate. While the effects of individual

elements of regulatory change have been modelled, the aggregate impact of the range of new regulations is unknown (BGLN, 2012).

- **New systemic risks arising from regulation**

Many of the new regulations are designed to define, identify, and regulate systemically important financial institutions (SIFIs) to avoid another crisis involving state-funded rescues of failing institutions (BGLN, 2012). Although important progress has been made, some of the new regulations may inadvertently exacerbate too-big-to-fail¹⁴ concerns or create new, unexpected SIFIs. These institutions can reduce risk by providing greater transparency and clarity regarding aggregate risk exposures, but at the same time, reliance on them as single-point institutions may contribute to new forms of systemic risk (BGLN, 2012).

- **The impact on bank business models, risk profiles, and resultant bubbles:**

Now as before the crisis, banks need to earn an attractive risk-adjusted return for their shareholders, but this is yet more difficult given new regulations, and the state of the global economy (BGLN, 2012). As a result, they are exploring new lines of business, product offerings, and markets, which bring with them new sources of strategic and operational risk (Protiviti, 2013). The most important battle facing the international banking system is the ability to model returns and risks on businesses given regulatory changes and new capital requirements. If many financial institutions pursue the same types of new opportunities as regulators impose restrictions on existing businesses or products, bank business strategies could become more highly correlated (BGLN, 2012). The resulting aggregate market pressure could both

depress long-term returns as asset prices are bid up and increase systemic risks as the correlation of banks' activities rise, which is a recipe for new bubbles.

- **Significantly enhanced consumer protection and associated litigation risks**

At the 2011 Bank Directors Summit, bank directors discussed the challenges of serving customers and clients profitably with Elizabeth Duke, a member of the Board of Governors of the Federal Reserve System (BGLN, 2011). Participants said that strengthened consumer protection measures bring to fore the thorny question of fairness, both in the United States and Europe, and they worried that the trend to put protective measures in place was spreading from retail customers to high-net-worth and institutional clients (BGLN, 2011). The establishment of the United Kingdom's Financial Conduct Authority (FCA) and the new CFPB¹⁵ in the United States raise questions about how regulation of market conduct and consumer protection will operate in major markets. The costs of litigation are colossal if added up across the industry. There is more to come, and it could be devastating (BGLN, 2012). There are things banks will do for customers who are underwater on mortgages. Many of those things are legacy costs. These legacy costs present challenges as banks try to move ahead with new business models and new product development (BGLN, 2012).

A dynamic and often murky, regulatory environment arguably remains the top challenge for financial services institutions (Protiviti, 2013). New and upcoming regulations in the European Union (EU), UK and US, not to mention other jurisdictions, are sure to have a significant effect on financial services organisations, as are pronouncements from the Basel Committee on Banking. For multinational institutions, almost certainly

¹⁴ The "too big to fail" theory asserts that certain financial institutions are so large and so interconnected that their failure would be disastrous to the economy, and they therefore must be supported by government when they face difficulty. The colloquial term "too big to fail" was popularized by U.S. Congressman Stewart McKinney in a 1984 Congressional hearing (Dash, 2009).

¹⁵ The Consumer Financial Protection Bureau (CFPB) is an independent agency of the United States government responsible for consumer protection in the financial sector.

will be confused and lack of clarity with regard to different, and perhaps competing, compliance requirements that they will need to dissect carefully (Protiviti, 2013).

3.3 Cyber security and other geopolitical risks

Cyber security and other geopolitical risks present unique oversight challenges (BGLN, 2012, p.1). Bank risk officers, directors, and supervisors are finding that they must pay increasing attention to geopolitical risks, including the risk of cyber-attacks from both state and non-state players (BGLN, 2012, p.1). During two days of discussion on 15 February 2012 in New York and 29 February 2012 in London, participants (Directors, Chief Risk Officers, and Supervisors) in the Bank Governance Leadership Network (BGLN) find that increasingly, geopolitical risk is climbing up the risk agenda, and in particular that unique form of 21st-century geopolitical risk is cyber security (BGLN, 2012, p.8). Cyber security has shot up everyone's agenda due to state-sponsored cyber-attacks, the activities of anarchic hackers such as those comprising anonymous, and the almost weekly reports of banks' losing customer data (BGLN, 2012, p.8). The magnitude of the challenge is immense. As Robert Mueller, director of the Federal Bureau of Investigation (FBI),¹⁶ said recently, "Terrorism does remain the FBI's top priority, but in the not-too-distant future, we anticipate that the cyber threat will pose the number-one threat to our country" (Jaeger, 2012). But traditional geopolitical risks are also high on the risk agenda, thanks to political and social upheaval in the Middle East and Africa, electoral and political changes taking place in Europe and the United States, and the global rebalancing of power between the East and West (BGLN, 2012, p.8)

¹⁶ The Federal Bureau of Investigation (FBI) is a governmental agency belonging to the States Department that serves as both a federal criminal investigative body and an internal intelligence agency (counterintelligence). Also, it is the government agency responsible for investigating crimes on Native American reservations in the United States (Intelligence.gov. 2014).

Banks manage massive amounts of data, which makes their technology requirements quite complex and makes them a target-rich environment for fraud or cyber-attacks (BGLN, 2012, p.8). Many large banks grew through acquisitions and as a result have pieced-together legacy systems, which require significant investment to integrate, update, and protect. Information technology (IT) is also an area in which few directors, executives, or supervisors have applicable experience and expertise, increasing the oversight challenge as internet crime and fraud are also on ascendance (BGLN, 2012, p.8).

The cyber security threat to banks is particularly acute because of the amount of data they manage, the sensitivity of the data, and the potential threat to the broader financial system. The IT security threat falls into two main categories (BGLN, 2012, p.8):

- **Cyber terrorism**

The greatest threats are those aimed at bringing down an institution or causing a disruption of the financial system. At some point, state sponsored terrorists may use this to attack countries to bring down financial systems to cause economic panic. Causing economic panic is a pretty effective tool. The speed at which technology evolves and emerges leaves all institutions vulnerable.

- **Data loss**

The loss of retail data is "a daily occurrence," but can cause significant reputational damage. A disgruntled IT manager somewhere can sell data. This risk may increase in an environment of cost cutting, because it increases the risk that people feel disaffected. It is therefore not how big your locks are, but how you operate, knowing that the threats are in your systems (BGLN, 2012, p.9).

Geopolitical risks include the possibility of social and political upheaval caused by macroeconomic conditions in Europe and the United States and the potential for new conflict in the Middle East (BGLN, 2012, p.9). Following Russia's military intervention in Crimea, the situation

in Ukraine remains extremely fluid. The outcome will determine to a large extent the systemic nature of the crisis and its impact on global banking system, not just Europe. The current relationship between Russian on one side and Europe, USA and other parts of the world on the other side, leading to restrictions/bans and counter restrictions/bans is a serious geopolitical risk for the international banking system. Banks should prepare for the second- and third-order effects of some of these geopolitical scenarios, especially concerning:

- **Increasing probability of a major conflict in the Middle East**

The risk posed by Iran's nuclear program and the potential response from within the region, which could impact US 'response (BGLN, 2012, p.10)

- **Re-emergence of political risk in Europe**

Infighting in Europe could erupt and one or two big markets dislocated. The middle ground in Europe is disappearing. There are two historical precedents that one must be conscious of: The 1930s, which saw the rise of Nazi Germany¹⁷ and Communist Russia, and the 1970s Red Brigades,¹⁸ etc. It is a material risk which should not be ignored (BGLN, 2012, p.10).

Cyber-attack will continue to pose a serious threat, as well as Distributed denial of services (DDoS) attacks (Protiviti, 2013, p.4). These are becoming increasingly sophisticated and, in some cases, are being attributed to not only the global hacker groups, but also to certain foreign nation's intent on creating major disruptions in the United States and other countries (Protiviti,

¹⁷ Nazi Germany and the Third Reich are common names for Germany during the period from 1933 to 1945, when its government was controlled by Adolf Hitler and his National Socialist German Workers' Party (NSDAP), commonly known as the Nazi Party.

¹⁸ The Red Brigades (Italian: *Brigate Rosse* often abbreviated *BR*) is a paramilitary organization, based in Italy, which was responsible for numerous violent incidents, assassinations, and robberies during the so-called "Years of Lead". Formed in 1970, the organization sought to create a "revolutionary" state through armed struggle, and to remove Italy from the North Atlantic Treaty Organization (Westcott, 2004).

2013, p.4). In many cases, these attacks begin with financial institutions before spreading to other organisations. Another major concern continues to be Advance Persistent Threats (APTs). Financial institutions will need to be investing significant time and resources to detecting and preventing these highly invasive and potentially catastrophic attacks.

3.4 The general economic picture

Economic and market conditions continue to pose both short- and long-term risks (BGLN, 2012, p.1).

There is a general concern over the consequences of a prolonged low-growth, low-rate economic environment, including the associated risks of loss of talent during the current industry upheaval and fatigue and operational risks from the sheer amount of change (BGLN, 2012, p.1).

- **Prolonged low-growth, low-rate economic environment**

As central banks continue to pursue stimulative monetary policy, and households, corporations, and governments continue a multiyear deleveraging,¹⁹ there is a risk that the present low-rate, low-growth environment will persist for many more years (BGLN, 2012, p.10). Higher capital requirements can result in a short-term restriction of available capital in the economy, and at higher rates of interest, may create an additional constraint on the longer-term growth rate potential of the macro economy, or may tip the broader economy into a new recession (BGLN, 2012, p.10). Regulatory enforcement of more capital for the banks will have a procyclical effect. Quantitative easing could ultimately lead to a chain of consequences that includes higher inflation, which would cause interest rates to rise, demand to fall, and income to fall, all exacerbating low-growth expectations (BGLN, 2012, p.11). Regulatory intervention could also impact financial markets and the availability of

¹⁹ Simultaneous reduction of debt levels in multiple sectors, including private sectors and the government sector (BGLN, 2012).

credit. If economies underperform for many years due to a low-growth environment, highly indebted countries will be unable to improve debt ratios through growth, causing the market value of sovereign debt held on bank balance sheets to shrink (BGLN, 2012, p.11).

- **Loss of talent while the industry goes through major transformation**

The industry may be heading toward a new “banking-as-utility” equilibrium of simpler products, higher capital reserves, lower risk, more encumbered balance sheets, and lower resulting returns, similar to the situation in the 1950s (BGLN, 2012, p.11). The series of crises impacting the financial services industry and the massive changes underway could take a toll on the industry’s ability to attract and retain top talent. There is a worry about whether supervisors have the ability to attract and retain the necessary talents. For example, UK’s National Audit Office (NAO, 2014) records that the current levels of staff turnover at Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) (UK’s financial services industry regulators) are very high, resulting in consistent departure of skilled and experienced staff. For example 26 per cent of all PRA resignations in 2013 were classified as ‘high performers’ and 34 per cent of FCA staff in October 2013 had less than two years’ service at the FCA (NAO, 2014). The creation of so many new regulations has increased staffing needs at regulatory organizations, creating challenges for recruiting, training, integrating, and deploying new high-quality staff as the organizations struggle to implement new policies, many for the first time (BGLN, 2012, p.11).

- **Fatigue and operational risks from sheer amount of change**

The amount of changes that is taking place across the industry, IT; people; organizational structures; among others is causing a sense of overload on banks, with too much stress across the firms (BGLN, 2012, p.12). Within banks, several

developments are also pushing operational risks up the agenda. These include shifts in business models, movement into scale economy businesses, cost cuts that complicate firms’ abilities to maintain appropriate risk and control functions, ever-growing political and regulatory attention on operational processes such as mortgage handling and anti-money laundering (AML),²⁰ new consumer protection rules, and outdated IT systems (BGLN, 2012, p.12).

4.0 CONCLUSION

The international banking sector made a remarkable flourishing during the last decade, as it is considered to be the workhorse in flowing funds from one country to another. Along with the development of the banking industry, risks continue to pose a hazardous situation for the risk managers working on them. Because of the connected system of the international banking environment, a failure in one country can now cause a domino effect in several countries (Tebogo, 2012).

Banks are trying to keep track of macroeconomic, geopolitical, and operational risks, all while complying with new regulations, adapting to a rapidly changing environment, and maintaining profitability. Handling the array of new risks and ensuring their institutions thrive will require creativity and stamina on the part of executives and directors alike.

As the international community goes through a process of soul searching and introspection in an effort to understand the causes and consequences of the 2008 global financial crisis, in which international banks were at the epicenter, looking ahead to anticipate the configuration of the international banking system would help not only to formulate regulatory reforms to strengthen the banking sector itself, but also

²⁰ A set of procedures, laws or regulations designed to stop the practice of generating income through illegal actions. In most cases money launderers hide their actions through a series of steps that make it look like money coming from illegal or unethical sources was earned legitimately (BGLN, 2012).

to inform the current debate on international macroeconomic policy (Dailami & Adams-Kane, 2012).

5.0 RECOMMENDATION

One of the important lessons from the financial restructuring experience in developing Asia is the need for strong legal and institutional support, accompanied by government resolve to improve the financial system, Senate Economic Planning Office (SEPO, 2005). Improved insolvency laws and enhanced efficiency of judicial systems are needed. Consolidating the financial supervision and regulations, for example, Basel III must likewise be encouraged to complement the emergence of different financial instruments available in the market. This should also boost the confidence of the public in the capital markets and unload the burden from banks in financial intermediation.

Given the significant international presence of European banks and their deep role in global interbank markets, the potential for spillover of the negative feedback loop among public finances, the financial sector, and the real economy currently underway in the euro area should be of concern to the broader international policy community.

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