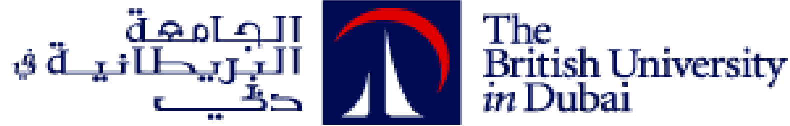


**An analysis of important market risk that international bank face**

**دراسة حول مخاطر السوق التى تواجه البنوك الكبرى**

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**Abstract**

International banking can be beneficial, especially about developing a stable financial system. However, the international banking system also faces major problems. This paper attempts to identify market risks that exist in international banking and discuss on the risk management. It also discusses the importance of international banks managing these risks. The study used questionnaires as the methodology for collecting data. The questionnaires were distributed to 30 senior managers/officers in various international banks around the world. The questionnaire had three sections, with the first part requesting demographical information such as gender, age, education level, race and respondents' judgments regarding the goals and importance of risk management practices as well as the where these market risks arise. The second part focused on obtaining insight about some of the market risks international banks face and how they are managed. The five-point Likert scale was used to rate individual factors. The third part of the questionnaire contained open-ended questions that sought to obtain more qualitative information from the bank officials regarding risk management techniques and their specific understanding and attitudes regarding the major market risks and practices used to manage them. From the data analysis, the study found that international banks face a narrow range of market risks mainly resulting from liquidity, interest rate and foreign exchange rate. The banks are not employing diverse risk management techniques and only focus on blunt tools for mitigating and eliminating market risks instead of employing advanced strategic techniques such as hedging, diversification and analysis of value at risk to manage market risks. The study provides recommendations that can address the issue, including improving counterparty credit assessment and transparency, improving counterparty risk management, reporting and estimation, improving market conventions and practices and regulatory reporting.

نبذة مختصرة

البنوك الكبرى تكون مفيدة جدا عندما تساعد فى استقرار النظام المالى ولكنها فى نفس الوقت تواجه بعض المخاطر والمشكلات الكبيرة فى هذا البحث سنحاول ان نحدد المخاطر التى تواجه البنوك الكبرى ونناقش كيفية ادارة تلك المخاطر وكيف تقوم تلك البنوك الكبرى بادارة المخاطر. فى هذة الدراسة نتبع المنهجية واستطلاع الاراء لتجميع المعلومات المطلوبة عن كيفية ادراة المخاطر . نحن قمنا فى هذة الدراسة باستطلاع اراء ثلاثون مسؤول عن ادراة المخاطر من مختلف البنوك الكبرى حول العالم . الاستطلاع مكون من ثلاثة اقسام القسم الاول يتكون من معلومات عن السن والمستوى التعليمى والعرق واستراتيجية وضع الاهداف بالنسبة للمديرين واهمية ادارة المخاطر بالنسبة لهم وكذلك عن المصدر المحتمل لهذة المخاطر . اما القسم الثانى فيركز على المخاطر التى تواجه البنوك الكبرى وكيف يتم اداراتها بواسطتهم اما القسم الثالث والاخير فيوضح باستطلاع اراء هؤلاء المديرين ماهى التقنيات والطرق التى يستخدمونها للادارة مخاطر السوق المالى والحصول منهم على معلومات رقمية بهذا الخصوص وكذلك عن استراتيجيتهم للادارة تلك المخاطر والطرق التى يستخدمونها لهذا الغرض .. فى هذة الدراسة وجدنا انا البنوك الكبرى تواجه سيل من مخاطر سوق المال التى تتمثل فى الغالب فى نقص السيولة المالية واسعار الفائدة المرتفعة وكذلك التقلب فى اسعار العملات . وفى اغلب الاخوال وجدنا ان البنوك لاتركز على مواجهه المخاطر بل العمل فقط على تقليل الخطر فلا تستخدم مثلا نظام التحوط او التنوع فى المعاملات المالية وفى هذة الدراسة نقدم مقترحات التى تحدد المشكلة وتقدم الحلول كوضع استراتيجية افضل لتقييم المدينين والشفافية فى وضع التقارير الخاصة بالمخاطر حتى يمكن ادارتها بسهولة.

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# CHAPTER 1: INTRODUCTION

The purpose study of the research is to assess the extent to which international banks face significant market risk. This chapter will discuss the background of the study, statement of the problem, the purpose of the study, objectives, hypotheses, justification and significance of the study, limitations and assumptions of the study, respectively.

## Background

The international banking sphere evolved from domestic institutions, which were previously limited only to national jurisdiction, into interconnected financial institutions, which became subject to regulations that cut across national borders (Sotelino 2015, p.45). The institutions became the custodians of financial obligations of the current models of universal banking systems. Financial market participants, such as those who deal with insurance, retail, and wholesale services, developed beyond the geo-historic scope and in the past three decades has greatly improved. Hence, banking internationally became contingent on a stable currency, a growing base of retail clients and a robust central bank, which needed credit defence to improve its operations.

Consequently, the global economic roles played and still currently performed are based on the particular form a bank took and its geographical coverage. International banks created a vital element of financial integration that was elevated by globalisation, which increased worldwide trade (Haynes 2005, p.32). In this way, the international firms' financial functions were performed imperatively by the integration that was created. In the European Union, financial market integration gained popularity and raised the momentum of adopting the manners with prioritization of the closure of single financial market.

More so, the international banks help in forming worldwide financial markets as they form financial intermediation and a market infrastructure, which are resilient for a healthy working financial system (Bowling & Rieger 2005, p.34). Hereafter, several benefits are usually enjoyed especially when banks expand globally. As they are doing this, they are merely "following" their customers around the globe. The multinational corporations become new clients of multinational banks, which operate in a vast array of regions worldwide. More so, the expansion has made it possible for the banks to access a larger pool of technology, which is up to date and profitable. The technology is mainly found among clients who are concentrated in small numbers across different sections of the globe. It also increases and improves the diversification of availability of sources for borrowing and lending to customers. It gives parties, the clients, and banks a mutual advantage in the market.

However, the market being the vital part of a business' existence and sustainability considering the customers' needs, such variation in flow can increase market risk when banks experience financial pressure. These burdens are usually unanticipated in the market, and some international banks may fail to notice them when they occur. In fact, the European Union revised its regulations guiding financial services after the global financial crisis of 2007-08.It expanded the fragmentation of singularity of the financial market as one of the consequences due to the debt crisis. In an in-depth look at the international bank market, financial market risk has been suggested to be the most important of all the risk experienced since it covers a wide area that the banks are involved. The risks include credit risks, like financing trade and interest rate risks, operation risks and liquidity risks.

For international banks meet different financial obligations, they must be considered and extensive measures like operation skills should be incorporated well. Operational risk has

increasingly caused problems within banks' internal and external systemic events thus failing the whole process in general. The finances being poured in the banks' operations have to be properly accounted for; therefore, the management system should focus on both related financial skills and the financial power to operate (Turner 2006, p.51). This is also true for risks that are associated with a lack of technological information linked to bank management systems. If banks lack sufficient financial support, there will be inadequate money to acquire necessary and current information in the market for improvement of the international banking systems, potentially leading to its collapse in the long run. In relation to this, liquidity risk can sabotage the system since it is a fact that will show how daily banks' activities have failed due to insufficient operating funds. Hence, financial obligations must be met to maintain an improved and consistent reputation in the financial market to avoid reduced privileges. It will ensure that the international banks are able to adjust to financial difficulties when hit by economic recessions. In this way, if the banks honour their financial commitments to different states, governments and the public, they will not be forced out of the market.

Considering international banks lending operations, issues that are related to the process that causes stress to the system, especially during global financial crises. According to an analysis from the World Bank (2013), financing trade is a significant market risk faced by the international banks. As it relates to financial issues, several investigations have revealed that international banks experience high credit risk levels (Carroll 1998, p.43).

Additionally, 2005 saw the introduction of Global Trade Finance Program (GTFP) by the International Finance Corporation (IFC), part of World Bank Group, in support of the trade finance extension to underserved global clients (‘The changing role of international banking in development finance’ 2013, p.23). Therefore, financial institutions should utilize supervisory

review processes to evaluate their capital capability about the credit risks they face. It might help in improving forecasts related to the fluctuation of financial market risks.

Different financial market risks are interrelated, and it is difficult to separate them. Thus, one financial risk may cause another risk until it leads to the downfall of the bank if a solution is not provided in due course. These issues may be the same to all the international banks and inter-twined to the daily activities. Moreover, Lang and Nayda (2008) have a different view, arguing that the related interest rate risk challenges many banks due to financial inflation that is a hazard to the financial industry. Unsteady changes in interest rates in the market affect the loan portfolio and securities of fixed-income (Lang & Nayda 2008, p.45). The targeting of inflation has become one of the major approaches to combating global financial crises.

Since the 2007-08 financial crises, most of the central banks have succeeded in achieving stability in prices and inflation. Recently, events have revealed critical issues, such as support for financial security based on sound monetary policy (Lang & Nayda 2008, p.45). It has involved different approaches to targeting inflation in order to get offers that have potential advantages for financial stability. International banks have embraced inflation procedures based on money to have high economic power during increases in global inflation.

In addition, all the operations that are financially related in the market have compliance issues since dealing with cash is a critical issue by itself. Increasing regulations in the market based on transparency and accountability have made the structures of the financial organisation crumble under the pressure (Carreta, Farina & Schwiser 2010, p.12). New and improved structures are being built to support and improve compliance and handle new and better practices. This "systemic thinking" is a current management concept that is gaining acceptance

(Carreta, Farina & Schwiser 2010, p.56). It helps international banks with adhering to the complexity of their functions of compliance and businesses. The system appears to be better in understanding and describing organizational complexity in the financial market. In this consideration, an update of risk management software, techniques and methods are paramount to international banks.

Furthermore, despite improvements in financial stability by advanced economies in the world, the International Monetary Fund (IMF) assessed the emerging risk rotates around the markets. Weak market systems threaten the liquidity of the international market such as advanced economies of scales and legacy issues (International Monetary Fund 2015, p.21). Subsequently, even though the financial market risk is termed as a fair waste in the global financial institutions, there is another risk. The risk is simply human capital and how it relates to the trade structure of the international financial system. The majority of the banking industries are faced with risks caused by inadequate human, which causes risk management due to lack or insufficient skilled finance managers (Hassan 2009, p.78). Moreover, the system that deals with management risks should also take into account environmental uncertainties, which may affect the process of human decision-making. Therefore, an acknowledgment of the full process is paramount and must be addressed in full measure. It will put to rest the assumption that market risk is independently occurring and reoccurring.

International banks face hardship and pressure that force other banks out of the market due to insufficient or total lack of overall management and compliance of the international banking systems. This was experienced during the 2007-08 crises, which threatened the achievement of the single market (Garcia 2009, p.67). There has been extensive debate about how to safeguard against future bank failures. The determinants of success or failure of international banks

includes the inability to spot potential global relationships which banking systems do not manage properly.

Additionally, consumers are impatient in regards to credit and product complexity and both these have led to failures significantly. In addressing the low-risk management process that existed, the European Union through the European Commission has been creating better financial crisis response procedures, which involve correcting the regulatory and supervisory structure. The developments are consistently improving the compliance roles. Garcia (2009) notes that the European Union has put respect to laws and regulations as their primary supervisory objective. Bank industry executives have provided vital information about international trends that will influence the industry concern with the retail banking (Martínez Peria & Mody 2004, p.54). The burdens of regulations have intensified, forcing banks to take a proactive approach to manage compliance. It is mainly due to partnership risk and heightened requirements for security and privacy.

Following the different financial market and management issues, several research factors can be observed and undertaken to correct and improve the way international banking systems operate. The factors are considered the strategic compliance drives in practice and support of practitioners. The research objective is one of the factors that can be adopted regarding the legal framework in the banking sector for proper compliance (Carreta, Farina & Schwiser 2010, p.56). Having a particular aim is necessary in the industry to evaluate financial reforms adhering to the development of a theoretical constitution for compliance management. In support of this, different tasks must be undertaken for a better approach to market issues. The tasks may include developing an improved system for obtaining knowledge and new information around the market compliances and evaluating the importance of different global sanctions.

Additionally, any solution should include an analysis of policies that govern a particular financial market in a different region and their comparisons. Based on all the factors in place, it has been noted that compliance knowledge is being taken seriously across all sectors of financial businesses (Bowling & Rieger 2005, p.89). In this way, organisational models have changed significantly with bodies in charge of supervision having new significant consistency on knowledge bases.

It is evident that the banks are facing a relatively slight range of risks. Nevertheless, the banks are not all yet using the array of risk management observations. The various banks have their own unique perspective as it relates to different risks, and operational and market risks are put in the same category. In the same breath, the exchange rate and reputation risks also receive the same attention (Bowling & Rieger 2005, p.69). This implies that each of the banks has developed differently on a major scale in the system over time. Regarding practices concerning management risks, they seem unsophisticated when it comes to the tools accessible to absolute management risk. It shows a lack of understanding of the international financial market.

Many researchers have conducted and discussed determinants of success or failure of international banks. In most of the discussion, notably relevant and consistent are the financial and management entities in the financial market. Therefore, an analysis of financial market risk and management of the system that international banks experience is essential for proper compliance in the international banking system (Mclinden, Fanta, Widdowson & Doyl 2011, p.23). An examination of the different techniques and practices in the system is also crucial in determining the factors leading to the experienced risks all over the financial market. In the research, the participants will be randomly selected to capture a diverse range of information on

an international scale. This means that the individual respondents who work for banks will form the target group of the entire required international market.

**Statement of the Problem**

The evidence in the literature is that while international banks face different market risks, but there are risks that require greater concern. Financial market risk is considered one of the most critical issues of the international banks. Dealing with customers and the lending issues that come along with credit increase the riskiness of certain financial factors (Mobius 2007, p.28). The explanation is clear since the presence of the fluctuation of interest rates, which may lead to a loss of customers, is often experienced in the market. This issue can be further complicated by the rising competition in the financial industry hence exposing and exploiting the weak points of international banks.

In relation to financial factors, management issues are the most overlooked in the financial market. Concentration on the financial risks and compliances of its laws and regulation makes international banks fail to boost their management power (Morra & Rist 2009, p.25). For success in the financial market, banks must invest in secure and reliable human capital, particularly with appropriate knowledge and skills in conducting the activities, for the long run success of international banking systems.

Therefore, the extent of the international financial market goes up to the management level for the success of the whole system (Rickards 2014, p.64). Categorizing risks regarding how relevant they are to the market may assist in properly managing the international financial system. This research will attempt to fill the gap that has been created by not merging management and financial risks that exist alongside each other in the international banking

system (Rechtschaffen & Trichet 2014, p.34). By assessing the extent of the risks, it may be possible to offer proper solutions to the various stakeholders.

## Purpose of the Study

The purpose of the research is to investigate the degree to which the most significant market risk the international banks face.

## Objectives of the Study

### Specific objective

The particular goal of the study is to explore the most significant market risks that international banks face.

### General objectives

- To analyse the significant risks that international banks face in the financial market
- To investigate risk management practices used by international banks to deal with market risks

## Hypotheses

The analysis of the extent to which market risk affects the international banking system calls for testing of both the null and the alternative hypothesis. Below are the alternative and null hypotheses for the study.

### Null hypothesis

$H^o$: Market risk is not a major risk that international banks face

### Alternative hypothesis

$H^1$: Market risk is a major risk that international banks face

**Rationale of the Study**

International banks, although a source of financial risk, boost the world economy as they help facilitate global investment. Therefore, different countries can mutually benefit from this interaction, and in turn, boost the economy (Bowling & Rieger 2005, p.89).The banks can assist various countries and states to develop their financial stability through loans that help in covering part of their financial budgets. The loans can be repaid over time with reduced or low interest rates.

However, crises can befall international banks based on unfair financial competition, and when countries decide to liberalize their financial regulations. Therefore, the paper will attempt to identify the risks associated with international banking and how they can be managed to overcome financial crises whenever they affect the global financial system (Robinson 2001, p.67). The study further discusses how the risks and benefits relate to international banks and therefore the global financial system as a whole. Therefore, it may assist the international banks better to handle market risk in the global economy (Sobel 2013, p.55). Additionally, the research may form part of the needed pool of information required for online reference purposes by international banks when the need arises.

**Limitations**

The study considered a global platform as having different international banks that act as representatives of the completely international banking system. Therefore, this means it was a global survey since the study dealt with international banks. In addressing the objectives clearly, the necessity of a questionnaire was appropriate to handle them properly. The use of questionnaires helped in identifying the extent of the market risks, benefits, and gaps that need to be filled in the international financial system (Stiglitz 2010, p.32).

On the other hand, the surveys given out did not necessarily carry the information intended for the research due to respondent negligence. In answering the most significant risks and practices in the market, different respondents may identify even minor problems as the primary market issues that international banks face, even if the problem is unique to those particular banks (Spiegeleer, Schoutens & Jabre 2011, p.66). A literature review was appropriate to explore different views of various individuals who had conducted earlier research on the same issues.

In order to develop broader data based on the objective questions, multiple major factors were presented to the respondent to choose the most appropriate answer. For contradicting literature, the consideration of the most common factors in the literature with reliable sources was paramount. In this way, there were minimal limitations regarding the coverage and presentation of results (Tarantino & Cernauskas 2012, p.92). The consumers of this information should consider the limitations that have been addressed and in every result found the limitations relate to them.

**Assumption of the Study**

The study assumed that, the answers given in the questionnaire are correct and relevant to the study. More so, another assumption is that the selected respondents represent different international banks and have faced market risks in their lifetime.

# CHAPTER TWO: LITERATURE REVIEW

## Overview

This section contains a review of the literature on the analysis of the most significant market risks faced by international banks. The section begins by providing the theoretical framework of the study and then followed by the review of the literature. The review of the literature contains the definition of international banks and the evolution with the trends. Thereafter, there is discussion on the different risk types faced by international banks. The nature of risks faced and strategies for risk mitigation follows with reflection of future of international banks concluding with the summary of the whole review.

## Theoretical Framework

The first theoretical framework entails the transmission of market risks such as liquidity shocks in the integration of banking markets. The study by Allen and Gale (2000) reveals a link between contagion of market risks such as liquidity and market integration as non-linear. The market risks are greater in banking markets that are partially integrated and with interbank links that are incomplete. The authors also show that contagion risk accelerates when liquidity and market risks buffers of the bank are depleted and when they are more pronounced (Walker 2001, p.98). This literature implies that integration of the banking markets can be significantly affected by how the banks manage their market risks that arise when managing liquidity, foreign exchange, and interest rates.

The second theoretical literature relevant to the study is based on the complexity and compliance theory. The world is becoming more complex due to advances in technology and globalization, which are the main drivers of complexity (Walter & Howie 2011, p.78). The international bank is very different from the domestic bank in terms of in size and productivity;

thus, they are more complex than domestic banks. According to De Andres and Valledo (2008), complexity in the banking, industry is influenced by incomplete information, which makes it difficult for stakeholders to monitor the decisions of the bank manager.

Therefore, complexity increases governance problems, which also include poor management of risks; thus, the board needs to manage their managers as well as provide valuable and independent advice, especially on how to deal with different risks that face banks. Complexity is caused by many factors. Human society is one cause of complexity cause as society advances, regulations also have to increase. Compliance serves as management, which helps restore order in a complex society (De Andres & Valledo 2008, p.66). However, compliance should be built in the business process even though the function of conformity is original. When the company can overcome the risk of compliance, the stakeholders in the enterprise can easily manage other risks that can affect productivity.

Hence, from the two kinds of literature, it is evident that international banks have characteristics that differ greatly from domestic banks. International banks engage in diverse and sophisticated ways to reach customers, employ business models, fund sources across the border and establish subsidiaries and branches abroad (Allen & Gale 2000, p.76). Therefore, these banks are prone to market risks that need to be efficiently and continually managed. Consequently, international banks need to analyse market risks, especially the financial market risks and identify channels that can effectively respond to the risks.

**Definition of International Banking**

Throughout history, banking has played a significant role in the integration of the international economy. The internationalization of business has however, improved the economy

to even higher levels. Substantial expansion of international banking took place in the second half of 19th century and from 1960 to 1990 (International Monetary Fund 2015, p.45). Recently, a fundamental transformation took place at the beginning of the 1980s, a period after financial liberation.

An international bank is one in which the bank's extension of credit headquartered in a given country where residents of other countries can access through lending along cross-border, local lending of associated located in foreign countries and lending ordered by affiliates situated in a third country (Vine 2011, p. 65). The primary financial instruments of international banking are mainly loans, derivatives contingent and contract facilities and securities or deposits

International banks are more sophisticated when compared to domestic banks; thus more prone to market risks. These possible losses to the bank are caused by changes in market variables. For this reason, international banks need to have dynamic and comprehensive practices, techniques and methodologies that manage market risk through monitoring and measuring interest rate, liquidity and foreign exchange (Carroll 1998, p.43).

**Trends in the Evolution of International Banking**

According to the economic historians, the development of the modern international banking system was fuelled by three major waves. The start of the first wave took place in the 1830s and was facilitated the funding securities business that occurred in the second half during the 19th century by Lehman Brothers, Goldman Sachs and JP Morgan (McIlroy 2008, p.98). The firms assisted the US municipalities, states, and railroads through selling the funded securities to European investors in London.

The successive wave started in the 1960s and lasted for three decades. It was related to transactions of international banks among the developed countries. The last wave commence in the 1990s.Similar to the first wave, this last wave focused on concentrating subsidiaries and branches in developing countries (Vine 2011, p.62). Additionally, this wave was more retail business oriented, something that was absent in the earlier periods.

**The Growth of International Banking from the 1980s**

Significance of the 1980s is that the growth revealed how market risks occur on a global scale. The significant growth in the past decades on the activities of international banking systems accelerated even more in the period before the financial crisis. A drastic scale change of international investment took place from 1985 to 2009, which was facilitated by foreign banks' territorial claims and lending across the border. The amount of total lending by international banks as part of the GDP, which is a substitute for globalization in banking activity, increased gradually from the mid-80s to early 2000s by 4% per annum. It then sharply accelerated in the following years. The rate of total lending between 2002 and 2008 almost doubled but the growth was later interrupted by the financial crisis in 2007-2008, making the lending rates to remain almost at high level (Carroll 1998, p.43).

In the early 2000s, the growth of international trade resulted in increases in international lending (Arcalean *et al.* 2007, p.45). The rapid increase in international trade where the export of services and goods around the world accounted for a constant increase in the fraction of the global economy reflected accelerating levels of actual economic integration. Following this period, however, the activities of international banking expanded faster than the trading business. This outcome was possible because the trade did not adequately capture the actual economic

integration as enhanced international banking increased the expansion of companies internationally through foreign direct investments.

The other reason for international banking expanding faster than international trade was that the idea of expanding the international component of balance sheets of financial firms had changed. Therefore, intermediation channels lengthened in the past decades in international finance such as the establishment of securitization markets and risk transfer, which meant loopholes for losing money in the market. Therefore, the increased growth in activities of international banking during 2000 signalled a deviation between the financial and real integration (Arcalean *et al.* 2007, p.45).

The activity of international banking is an essential component of the comprehensive process of economic integration and globalisation. The measure of financial integration and globalisation is calculated from the total liabilities and external assets of a country's stocks about GDP. The total integration of the international finance accelerated from the mid-1990s among the industrialized nations and the rest of the world followed gradually (Turner 2006, p.51). According to Beck, Demirgüç-Kunt and Levine (2001), another indicator of the composition and growth of the financial structure growth is deepening of financial institutions and markets in the preceding decade. In relation to the financial crisis of 2007-08, the deepening manifested through rising profitability, reduced net interest margins and declined stability in banking sectors of countries with high income. Therefore, affecting the market relied upon for stability of international banking system at large.

**Evolution and Expansion Strategies of International Banks**

The composition of flows of international banking has significantly changed with the development of international banking. The local affiliates from foreign banks supporting lending across the border have extended the increase of issuance of bank credit to the non-banks. Simultaneously, the significance of interbank lending across the frontier as well as offshore centres has developed. Additionally, the structure of the active international banks corporate activities of balance sheets as well as the off balance sheets have transformed significantly.

The changes in the international banks were associated with two significant trends in their strategies. Firstly, there was a trend of foreign expansion via direct investment within the developing countries' banking systems from the mid-1990s (CGFS 2004, p.30). The banking systems in Eastern and Central Europe, as well as economies in Latin America, are now foreign-owned (Lang & Nayda 2008, p.45). After the establishment of local affiliates of the foreign banks, local balance sheets rapidly expanded, but the importance of claims across the border regarding market economies emerging declined. In relation to the retail-related strategies in the foreign banks, the share of borrowers from non-bank in private sectors increased from around 25% to over 60% total claims between 1985 and 2009 ('The changing role of international banking in development finance' 2013, p.89). Borrowers from public sector represented 15% of overall international claims from developing countries, a decrease of over 40% in the past two decades.

The other trend is characterized by rapid expansion of wholesale markets' activities such as derivatives and securities markets and interbank transactions. This trend is reflected by various changes in bank balance sheets' structure. In the past ten years, the increased dependence on capital market funding has led to the growth of the need of non-banks to be counterparties in liabilities of the banks (Arcalean *et al.* 2007, p.45). Additionally, the growing of foreign

affiliates' shares in liabilities of banks reveals the constant use of offshore markets and financial centres as sources of funding.

Additionally, transactions of off-balance sheets among international banks have developed rapidly. According to the banking statistics, off-balance sheets take international positions in guarantees extended, credit commitments and derivatives contracts. In the position of derivative, known as the derivatives' net value, hedge the positions of the balance sheet and not those that are for proprietary trading. From 2005, the period when information about these balance sheets was available, the growth of international banking outpaced the development of cross-border and local claims (Carroll 1998, p.43). Research reveals that US-based banks accounted for the largest growth in credit commitments and guaranteed extended amounts. Similar growth was experienced gradually in Swiss, Japanese and German banks.

**Different Risk Types faced by International Banks**

According to the World Bank (2013), financing trade counts as an important market risk faced by the international banks. It is clear since in 2005, there was the introduction of Global Trade Finance Program (GTFP) by the International Finance Corporation (IFC), part of World Bank Group, in support of the trade finance extension to underserved global clients ('The changing role of international banking in development finance' 2013, p.78). Additionally, in regards to trade finance, Carroll (1998) states that there are high credit risk levels experienced by international banks. Therefore, financial institutions should put into place supervisory review processes to evaluate their capital capability about the credit risks they face (Carroll 1998, p.43).

However, Lang and Nayda (2008) offers a different perspective. The author found that the most significant risk in the market is interest rate risk. The changes in interest rates in the market affect the loan portfolio and securities of fixed-income (Lang & Nayda 2008, p.45).

Based on this consideration, an update of risk management software, techniques and methods are paramount to international banks. Furthermore, despite improvement of financial stability by advanced economies in the world around, an International Monetary Fund (IMF) assessment concluded that the risk rotates around the markets that are emerging. Weak market systems threaten liquidity of international market that banks are involved such as advanced economies of scales and legacy issues (International Monetary Fund 2015, p.67).

Operational risk has been extensively investigated to be a vulnerability to loss resulting from failed processes, such as systems and internal and external events. Misuse of power, failure of the system of information technology and risks, which are risk-related, may lead to the collapsing of the international bank systems (Turner 2006, p.51). In fact, liquidity risk goes hand in hand with operational risk. Liquidity risk is considered the type of risk that explains how a bank is unable to carry out its daily activities due to a lack of cash. Therefore, adequate liquidity provision in the market for any bank is necessary because the lack of meeting other financial institutions' obligations can result in reduced privileges and poor reputation in the financial market. Hence, international banks have to keep up with the market standards to survive throughout the financial cycle. It goes on to reputation risk whereby international banks, which do not honour their commitments to governments and the public, are faced out of the market. Lack of observing corporate governance can lead to also negligence of bank's affairs, which also hurts damages, the banks' reputations (Turner 2006, p.51).

In addition, Arcalean *et al.* (2012) observed that globalization forms a sensitive part of the banks' international market. Globalisation has brought more opportunities critical to the success and survival of international banks. Even though there is a lot to be gained from the improved globalisation of banks, there is also increased the risk that can also lead to its failure

(Arcalean *et al.* 2007, p.45). The risks that might be experienced are inter-dependent, and the factors affecting one area of risk can extend to other range of issues.

Nevertheless, political risk is regarded as an essential element in the market with the issue of terrorism being in question. McIlroy (2008) argues that politics has been used to redirect economic activities internationally. The fact is evident and frequent in the developing countries. It has been found that the political issue affecting the international banks gives the market participants time to reconsider and view the effect of such risks on prices in the market properly especially during economic downfalls (McIlroy 2008, p.98). Therefore, knowing and .understanding the market risks that international banks face are important because the information is relevant to managing and controlling the risks (McIlroy 2008, p. 78). In this way, the risks can be managed to an extent that it prevents recurrent bank problems and averting failure effectively.

**Impacts of International Banks**

International banking has evolved over the past decades, increasing the international financial stability as well as gaining access to economic agents in a wider range of financial services. Expansion of cross-border banking activities has resulted in risks to the financial system and individual banks. This section discusses the impacts of international banking on economic growth and integration.

**Impact of International Banks on Individual Banks**

The expansion of international banking can affect the resilience and risk profile of individual banks through competition, efficiency gains, and risk diversification. These individual banks; thus, compete back to overcome these risks and this may threaten the international banks.

These banks usually turn to diversification of exposure that reduces the riskiness of the aggregate portfolio. However, when the bank enjoys the benefits of diversification it tends to create portfolios that are riskier to realise high returns (Girardone *et al.* 2004, p.89).

When it comes to the effect of the riskiness of a bank, efficiency gains, and competition are usually analysed as one factor. In the financial sector, competition encourages banks to utilize its risk-return frontier in its international aspect. Moreover, the more the international banks face competition, the more it fosters the overall efficiency of the bank. It also promotes the effectiveness of the risk management and measurement practices and tools. Altunbas et al. (2007) supported this view and found a negative relationship between riskiness and efficiency in Europe, although not in the United States.

**Impact of International Banks on Systemic Risk**

According to the global system perspective, the internationalisation of banking has an influence on risk sharing across the border. Higher risk sharing is frequently useful in gaining financial stability. For instance, Claessens (2006, p.54) found that through increasing risk-sharing, foreign banks' activities in a given country reduce the possibility of a financial crisis occurring, leading to a reduced behaviour of pro-cyclical lending. Similarly, De Nicoló *et al.* (2003) found that the same results are influenced by the extent to which risks are assessed accurately at every level in an institution. The findings were related to banking and discovered that foreign entry minimizes focus on host bank systems.

Assessing and managing cross-border risks also defines if international banks can add or eliminate local strain when a crisis is experienced. According to De Haas and van Lelyveld (2010), due to parental support, subsidiaries of international banks are not necessarily required to

restrict their credit when they are faced with a financial crisis in the countries that host them, but domestic banks have a need to restrict their credit during the crisis period. Furthermore, McCauley *et al.* (2010) found that international banks are more stable when lending domestically versus internationally. However, it depends on the condition of the parent institution. Therefore, the extent to which a country depends greatly on bank flows across the border affects the domestic banking system when the put is reduced.

In the dimension of international banking, is usually affected by issues related to information flow between prudential authorities and financial institutions. These items increase the vulnerability of the financial system. A good example is a complaint from supervisors from Eastern and Central Europe that international banks with systemic importance in the region usually release inadequate information regarding their operations (Turner 2006, p.51). Information issues have also contributed to albeit gradual, massive and build-up of mismatches in cross-currency on balance sheets of banks that are intentionally active, leading to adverse liquidity problems among interbank markets in 2007 and 2008. Additionally, issues of information have complicated resolutions of cross-border crisis such as arrangements of burden-sharing (BCBS 2010, p.23).

**Impact of International Banks on the Macro-Economy of the Host Country**

According to Claessens (2006, p. 40), international banking has a positive effect on economic efficiency and growth divided into five key channels. The first channel is the introduction of new financial services and products and the improvement of new technology use in host nations. The cross-border entry has improved the quality of the financial intermediation. Effects have been felt especially in countries with emerging markets. For instance, the introduction of mortgages dominated the Swiss Franc and Japanese Yen in Asian and central

European countries, allowing their economies to tap a developed investor base. Moreover, the accelerating rates of transfer of technology as well as contributing to higher wage levels will make the financial sector a field conducive to growth prospects and greater employment in developing markets.

The second channel is that foreign banks can exert pressure and improve the supervisory and regulatory frameworks. In some nations, international banks act as catalysts to speeding important reform processes, which improve the efficiency and growth potential of the host economies. For that reason, the host countries can boost their economy from the activities of the international banks.

The third channel is that international banking facilitates allocate efficiency. The international banks achieve this efficiency by eliminating distortions generated by a system that is overly concentrated (Beck *et al.* 2004, p.68). Additionally, the entry of international banks in a particular country is linked to eliminating lending behaviour based on political connections. Therefore, international banks level the playing field in the economy of the host country and reduce problems when making decisions (Giannetti & Ongena 2005, p.56). More so, in times of regional crisis, a locative efficiency establishes through constant access of borrowers from the host country to international financing.

The fourth channel is that when international banks enter in a host country, they set in competitive forces with other banks. The main consequence is the pressure that international banks put on local banks to use present resources in an effective manner. The other consequence is financial intermediation will lower in cost when measured by overhead expenses; bank

margins and spreads (Fries & Taci 2005, p.34). Such effects usually exist when the foreign entry is either by acquisition or by de novo, which is mostly the likely case.

The fifth channel is that dependence on lending from international banks comes with risks. The study done in Korea by McCauley *et al*. (2010) found that international banks reduced lending at a higher level compared to local banks during the financial crisis. During the crisis of 2007, it was revealed that during stress time, active international banks reacted by reducing lending across the border and local lending by foreign countries' affiliates were made more resilient. Notably, the best time that the reduction of credit can be seen in international banks is when exchange rate valuation affects the controlled stocks (McCauley *et al.* 2010, p.45). For instance, in 2008, lending taking place across the border during the fourth quarter fell to around 2 trillion US dollars at the constant exchange rate. At the same time, local lending dropped to 500 billion US dollars among the international banks as a way to respond to the crisis without affecting the banks (McCauley *et al.* 2010, p.25).

International banks will continue to play a crucial role since they are still gradually evolving in the financial integration process. This sign is clearly shown by the fact that the link between the investment decisions and country savings is still tight. Notably, even with wide-ranging financial integration in last 25 years, many studies still find puzzles even when the problem is slowly weakening (McCauley *et al.* 2010, p.75).

**The Nature of Risk Management in Banks**

In every operation in banks and other financial institutions, risk management plays a significant role in dealing with common risks such as financial and operational risks (Carey 2001, p.65). Carey (2001) also adds that various ideas of Turnbull are needed to manage risks

faced by financial institutions adequately. Indeed, with many risks facing banks each day, the Turnbull approach encourages banks to emphasise in risk management since it is almost impossible to eliminate it. Therefore, risk management should be at the top of the banks' priority lists, which will help them control it by using internal control system made specifically to eliminate risk exposure and adverse effects of risks that many international banks face.

Nevertheless, the literature is conflicting when it comes to the nature of risks international banks face. There exist two perspectives that revolve around competition: competition-stability and competition-fragility (Giannetti & Ongena 2005, p.56). The competitive stability perspective holds the view that when the market power is at the higher level among the banks; they tend to exploit the market power to make their customers pay increased interest on their loans. This idea increases risk since it makes it difficult for customers to repay their loans; thus, leading to a significant severe selection problem and moral hazard.

On the other hand, the competitive fragility holds the view that when bank competition is high, it eliminates market power that reduced firm values and profit margin. Therefore, banks encourage risk taking to retain margins (Berger *et al.* 2009, p.32). These two contrasting ideas in literature can, however, are reconciled by risk management through mitigating the overall levels of risks banks face via factors such as rising equity capital. According to Berger et al. (2009), banks with high market power reduce their risk exposure by proactive risk management, which helps reduce the risk caused by loan portfolio.

Banks working in specific areas, for instance, Islamic banks, which operate in several countries, usually face risks patterns and levels that differ from those in conventional banks (Ariffin & Archer 2009, p.65). This is because; banks in the Islamic countries have regulations

that are guided by sharia laws, which are different from laws in conventional banks. This idea is relevant in this study context because some of the international banks operate in countries dominated by many Muslims, who usually have some degree of association with Islamic finance. Therefore, laws governing the financial sector influence the nature of market risks faced by international banks in their host country.

Additionally, competing influences from organisational and individual judgments of risks that banks face are the other important factors that influence banks' risk management practices. Most of the risks that bank faces are corporate; however, individuals who make the last decisions conduct assessments. Therefore, it is crucial to understand that policymakers of an organisation should be concerned with wider-range considerations of the organization and not own biases when carrying out the assessments (Carroll 1998, p.43). This factor is frequently necessary for international banks where significant decisions are made every day. Bank officers typically limit their risk perceptions regarding lending of money to new customers. They overestimate risks that come with lending money to existing customers because of bonuses that bankers receive after getting new customers.

**Strategies for Mitigating Market Risks Faced by International Banks**

Strategies for mitigating risks require being linked to the corporate governance, which are the processes and systems of an organisation that protects the interest of the stakeholders. All of the interested parties in a firm share a similar interest, which is the constant growth and success of business. Therefore, many organisations understand that various stakeholders' interests should be addressed for the company to succeed (Bowling & Rieger 2005, p.34).The process of mitigating risks is one of the most important priority threats that help maintain the wellbeing of an organisation.

Oldfield and Santomero (1997) give three definitions of risk mitigation strategies and include simple practices in a business aimed at eradicating risks; active risk management and transferring risks to another participate who can deal with it. The financial sector should focus actively on managing their risks via their financial products such as balance sheets (Oldfield & Santomero 1997, p.34).

Allen and Bali (2007) analysed a sample of some financial institutions and estimated some of the measures of the operational and catastrophic risks carried out over a period of thirty years. The analysis noted that measures of operational and catastrophic risks have cyclical components, accounting for 20% of total return from financial firms; thus, these cyclical operational risks need to be compensated (Apostolik, Donohue & Went 2009, p.89). Depository institutions, for instance, banks, however, are altogether exposed to levels of operational risk of around 40% of the equity risk premium (Allen &Bali 2007, p.31). Unexpected and large catastrophic losses were found to be caused by critical operational risks since they usually coincide with events of market risk. Therefore, operational risk is a significant factor that can be used to mitigate both credit and market risks that remain causes of the crisis in financial institutions (Allen & Bali 2007, p.56).

Notably, credit risk also poses a substantial risk to the continued operations of the bank. Lang and Nayda (2008) carried out a study to examine the ways that strategies of credit segmentation can aid in preventing the default of credit card; therefore, assist banks in getting a better risk mitigation technique that can result in high capital returns. Evidence from the study indicated that institutions using well-updated information about the customers' financial histories can enable banks to alleviate most of the credit risk faced by banks; thus, nearly exclude the essence of compensating for loan seasoning and higher risks (Lang & Nayda 2008, p.45).

The other aspects of mitigating risk understand the way internal systems for rating risk of large banks implement the activities of mitigating risks. It is also important to comprehend if the system produces reliable estimates for credit risk portfolio of the said banks. A study carried out by Jacobson *et al.* (2006) found that there are considerable differences between two banks in loss distribution even when the said banks possess regulatory risk profiles that are equal.

The deviations in the two banks were caused by different levels credit risk portfolio and the size accounting for about 40% of the risk that each bank faces (Jacobson *et al.* 2006, p.76). It means that when mitigating risk, the need to implement and design reliable and accurate rating systems is critical as they incorporate different distributions of credit loss; thus, the capital structures required. Nevertheless, the study indicated that different mitigation strategies for various lenders with the same regulatory profiles of risks are differentiated by complex market equilibrium. Therefore, individual banks require different strategies for mitigating risks since each institution have different sources of risks that need specific strategies for reducing them (Jacobson *et al.* 2006, p.54).

**Reflections of Future International Banks**

The 2007 financial crisis highlighted the deficiencies in how most international banks manage their financial risks and carry out their businesses. Gaps were also exposed within the regulatory framework. Transmission of risks through active international banks was rapid across the system of global finance (Turner 2006, p.51). Additionally, macroeconomic problems that keep occurring needed improvements to the business models of these banks to help strengthen their liquidity and risk management. The improvements efforts have resulted in a reassessment of stability between economic benefits and financial security risks linked to international banking. It is evident that international business has contributed to a long-term progress of the world

economy. Internationalization of business for long in the past has closely trailed the development of international trade and realizing that financial and real globalization is intertwined (Admati & Hellwig, 2013, p.67). It has also driven global economic development and integration by supporting multinational firms and assisting in exploiting the potential growth of emerging and developed market economies (Lang & Nayda 2008, p.45). Additionally, international banks established local operations, which have improved the effectiveness of developing financial market systems.

Despite the financial crisis, a lasting trend regarding internationalisation of banking is expected to improve. With primary drivers continuing to evolve, its general patterns and pace are expected to be different from the earlier decades; thus, authorities need to put more efforts in shaping the future financial system that will pose more challenges (Turner 2006, p.51). Multinational development and international trade are some of the developments that are likely to have some effect on the future international banking. International banking is expected to expand as worldwide production and commerce activities grow. These activities can even lead to improvement of emerging market economies, particularly areas that show economic dynamism. It will also initiate financial integration through increased participation of active international banks in economies and expanded roles for international banks in countries with emerging markets (McIlroy 2008, p.98). These functions should be associated with consolidation across the border in the financial sector in emerging economies and industrialized nations and between institutions from developing economies.

The other significant development is related to the stability between the bank-based and market-based international intermediation. Economic growth is normally stronger and the benefits greater when market-based and bank-based financial intermediations accomplish the

certain functions (Cateora & Graham, 2007, p.78). The reason is that every intermediation type had different comparative advantages that are dependent on financial or economic development stage and display themselves in diverse industries and economic sectors. Additionally, the complementarily of markets and banks is improved by increasing interdependence of two intermediation types. Therefore, it is essential that financial system be complete (Arcalean *et al.* 2007, p.76).

From the recent crisis, it lent to the view that it is critical to highlight the significance of resilience in the banking sector and financial markets. Expanding the international capital markets' role as being the source of business financing has led to increased flexibility of markets during times of stress. Large corporations that are non-financial, especially those are mature and in developing economies, regularly resort to bond financing during periods of sharp contraction of bank credit, leading to the issuance of record levels (Arcalean *et al.* 2007, p.87). Similarly, banks help in providing external financing to medium and small-sized companies as well as households. Such borrowers are typically burdened by issues of inadequate information; therefore have indirect and limited access to the capital markets.

Broad trends in international banking have brought significant changes, especially in the regulatory environment. The authorities foresee a new regulatory framework that makes banks hold stronger liquidity and capital buffers and build resilient balance sheets that withstand funding risks. Many authorities in the host country are considering making an active regulation and local oversight. However, policy makers are facing challenges of dealing with limitations of international banking and at the same time improve the banks' functions efficiently (McIlroy 2008, p.98). International banks should make effective policies that foster development of markets for liquid securities that balance intermediation that is bank based. The policies should

also enhance market infrastructures and ensure that similar entities with the same functions receive equal regulatory treatment.

Regulation has been shaping the international intermediation for many years and they still play a crucial role in fostering knowledge transfer across the border. However, the results should not converge to a particular risk assessment of a framework of risk management that encourages weakened financial stability and herd behaviour (McIlroy 2008, p.98). Since no structure is perfect, embracing diverse approaches will help in adding more benefits to the regulatory framework.

Moreover, when formulating the new regulatory environment, it should level the playing field; thus makes everyone equal. International banks use competition as a way to promote growth (BCBS 2010, p.57). Therefore, adhering to levelling the playing field will help in setting goals that enhance transparency, supervision, and oversight of activities that are systematically important. For that reason, constant financial integration will be present in developing and developed market economies, making it possible for regulation to reach the global level indeed (Hardie 2012, p.45).

Competition can also contribute to reduced risk; therefore, to the lead to the development of balance sheets based on advantage during the crisis. Little evidence shows scale economies in large and active international banks. Nevertheless, some banks have expanded internationally or domestically to attain the status of too-big-to-fail (BCBS 2010, p.56). This status leads to moral hazard as well as market that is weak in monitoring risk-taking behaviour that is helpful to individual firms but destroys economic incentives and makes the financial system very fragile. Consequently, it highlights the need to have prudential buffers and conducts strict supervision

that restricts risks from building up. Bank resolution systems that are capable and credible are useful to complement banks with issues of too big status (BCBS 2010, p.90).

Additionally, when focusing on issues of risk and capital management, the crisis highlights the need for a careful analysis of international liquidity and funding management practices of a bank. When the authorities that hosted the international banks realised that the exposure of risks that came from the developing countries and that the credit lines of borrowers from across the border were drying up, there were many requests for a more decentralized model of international banking. A more decentralised model meant that the bigger part of the banking operations can be managed, supervised and funded in one location. However, it can restrict the spread of adverse risks across the national borders (Arcalean *et al.* 2007, p.45). The model can also make economic agents dependent on financial and economic conditions that can hinder the efficient transfer of money across the borders.

Moving towards a better decentralization of the international banking system is clearly associated with various trade-offs. Therefore, it is clear that it is not easy to design a financial immune system that will conceive all the market risks. Instead, policymakers should focus on finding more effective policies that are directed towards building strong mechanisms that prevent accumulation of excess local and cross-border risks and improve liquidity and capital management. Additionally, financial institutions should employ effective risk management practices that specifically deal with specific hazards. However, risks should be identified first, and deal with their importance. Listing in order of importance ensures that the financial institutions face problems that affect the business the most moving towards those that are less important. In turn, international banks can handle and manage their market risks that are the cause of financial crisis.

**Summary of the Review**

Conclusively, the literature explores on the transmission of market risks such as liquidity shocks in the integration of banking markets. Moreover, the definition of International Banking and the history of how lessoned can be learnt in closing the loops where risks occur have been captured with the significant role banks play in the integration of the international economy. The trends in the Evolution of International Banking, according to the economic historians and the development of the modern international banking system were investigated as well. Additionally, different types of international bank risks and their impacts with strategies for mitigating risks have been reflected on the literature. Finally, the future of International Banks has been inspected with the 2007 financial crisis highlighted and gaps were also exposed within the framework.

# CHAPTER 3: RESEARCH METHODOLOGY

## Overview

To identify the most important market risk and the risk management practices used, primary data was obtained from a set of questionnaires that were distributed to bank officers who work at various international banks. The questions sought to understand the market risks faced and how they are managed to prevent crises in international banks. The answers helped enhance the information in the literature given by different scholars. This section of the study gives the methods used to collect data, research model, the sampling period and method, method of data analysis and a summary of the entire methodology used in the study.

## Data Collection

The research used questionnaires that were distributed to 30 senior bank officers of different international banks over a 3 month-period, from October to December 2015. The officers were selected because they may have first-hand information due to their constant dealings in most of the banks' research projects. More so, the senior officers represent the targeted population across the globe. Of all the 30 prepared questionnaires, 18 respondents handed in fully completed questionnaires. The response rate yielded was therefore 60%. The questionnaire has three main parts that every respondent had to answer. The first part obtained personal information such as gender, age, education level and race. It also obtained information about respondents' judgments regarding the goals and importance of risk management practices as well as where these market risks arise.

The second part focused on obtaining information about some of the market risks international banks face and how they are managed. It also involved questions of whether the

current risk management techniques are effective or need improvement. The last part concentrated on understanding how bank officers understand the nature of bank risks and their attitude towards the management of the risks. The section used the five-point Likert scale rating to determine individual factors. Respondents were to rank their answers on a scale of 1 to 5 because of understanding the risks and their attitude regarding the tools for managing the risks.

The third part of the questionnaire consisted of open-ended questions to obtain more qualitative information from the bank officials regarding risk management techniques and their specific understanding and attitudes regarding the major market risks and practices used to manage them. The open-ended questions allowed the participants to provide clear answers of the quantitative questions. Therefore, the study was able to eliminate personal data given by respondents regarding risk and its management.

The data obtained was able to obtain both the internal information regarding international banks as well as external information from the research literature. These two forms of data allowed the study to use accurate data that would provide reliable results and analysis of market risks faced by international banks. Both quantitative and qualitative analysis may help add academic impact and value to this research. Risk management concept is not easily quantifiable or measures numerically; therefore, descriptive statistics may help give the quantitative analysis. Data was applied to statistical techniques to generate quantitative data that was easily represented and analysed to provide variance in international market risks.

**Research Model**

Main approaches of gathering data to address research questions involve the use of surveys and case studies (Saunders *et al.* 2007, p.87). Surveys and case studies allow the

research to investigate an issue in real situations. Case study combined with survey design model prevents the distortion of information under research since it emphasises on a certain context relevant to the needed information. Thus, focusing on comprehension complex situations involved in the study. In addition, the two methods allow researchers to obtain significant quantitative and qualitative data that helps explore the discussed in depth by revealing root causes of the problem. This study attempts to analyse a general topic on risks and their management in international banks, a broad research viewpoint was taken. Therefore, the study utilised research action and surveys contained in the literature review to obtain information in breadth. Therefore, it gives a considerable degree of academic thoroughness and depth.

**Sample Data and Period**

The sample of senior banks officers used to obtain data was randomly selected in a period of three months from October to December 2015. Data collected was analysed in various ways. One of the methods was the ground theory that used observation and categorization of data. The other methods were experimentation and ethnography. In ground theory, factors are observed and attempt to integrate the factors in many theoretical perspectives to explain the factors without involving and considering actors directly in the situation. Ethnography, on the other hand, entails an inductive approach where an observed phenomena is observed, factors that cause it are discussed and then key behaviours and factors causing the phenomena are decided (Saunders *et al.* 2007, p.76). The method does not use theoretical models or determination factors affecting the phenomena, but instead focuses on factors and actors having qualitative effect on the phenomena by looking at views of causal factors.

Experimentation is similar to the approach of ground theory. Ground theory examines existing scenarios such as theories to analyse data, but experimentation actively sets up new

scenarios and then uses the unfolded scenarios to relate to existing theoretical scenarios and predictions. Therefore, experimentation makes the researcher control various external non-causative factors that have confusing influences on outcomes that can be naturally observed; hence, makes it easier for the research to analyse impacts of particular factors.

However, it has been debated that experimentation gives levels of control that tend to produce an unrealistic environment. For instance, behaviour of an individual may not match the actual behaviour of the individual in an environment that is not controlled (Saunders *et al.* 2007, p.65).For the study, ground theory does not give clear theoretical arguments regarding the nature and management of financial market risks in international banks. Therefore, an ethnographic approach was employed in the study to determine factors that drive risk management in international banks.

The study also considered the use of qualitative and quantitative data that will differently contribute to the findings of the study. Methods, such as analysing and gathering of data and observations that could be quantified were used for the study; thus data obtained was numerically represented. Quantifiable data was obtained by taking actual observation as quantifiable phenomena, such as number of accidents, deaths and pieces of passed legislation. It was also obtained by requesting respondents to assign figures to qualitative factors such as using the five-point Likert scale to rank important factors in risk management in the international banking industry.

On the other hand, methods of collecting qualitative data aim at gathering information that cannot be quantified or represented numerically (Hunt & Terry 2011, p.67). This data is obtained by asking for peoples' opinions about particular topics and perceptions about causative

factors. Even though quantitative data can be easily analysed and be represented because it can be represented using statistical analysis and graphic form techniques, it is not usually considerably rich as qualitative data. Quantitative data only shows relationships between factors, but does not explain the reason for the occurrence of the relationship or explain unclear relationships that may exist between factors (Saunders *et al.* 2007, p.78). For this study, qualitative and quantitative data was used to fully benefit from the ethnographic approach. Quantitative data was used to analyse the most effective practices for managing market risks international banks face. Qualitative analysis was used to understand the drivers of the use of various techniques to manage market risks faced by international banks.

**Method of Data Collection**

The use of scales in the questionnaires was evaluated to determine their reliability by using the Cronbach's alpha. It determines consistency in the way respondents responds to questions in the scales. The Cronbach's alpha also determines reliability of the different variables. The Alpha has estimates the score variation that various variables have because of possible random chance or error.

Formula for Cronbach's α

$$\alpha = \frac{k}{k-1}\left[1 - \frac{\sum_{i=1}^{k} s^2 i}{s^2 sum}\right]$$

Where k is the total questions, $s^2sum$ is the variance of sum of test scores observed, and ($s^2i$) is the component i variance.

The reliability was assessed by calculating Cronbach's alpha on every question and for the entire data. The use of Likert scale was used to rate the answers of respondents to obtain

quantitative data. Calculation was done for questions in the last part that had used the five point scale to rank their answers.

**Conclusion**

The study used a primary method of collecting data, which is the use of questionnaires to find answers to the study research questions. The questionnaires were given to 30 senior officers of various international banks to share their opinions, attitudes and answers regarding market risks faced by international banks and how they are managed. Quantitative data was used to find out various market risks faces and the effective management techniques used. Qualitative analysis was also used to understand the factors that influence the use of the risk management techniques. Qualitative analysis helped in providing more information and analysis of the data obtained, as well as allowing the study to compare the results with secondary data from the literature review. Therefore, it helped increase validation of drawn conclusion (Saunders *et al.* 2007, p.78). The next section deals with results from the sampling process. The next section deals with results from the sampling process.

# CHAPTER FOUR: FINDINGS AND ANALYSIS

## Introduction

The research has different parts, which have been calculated separately and then combined as a whole, to get a general overview of the results. The initial results of questionnaire are covered in the first section, which was obtained by the analysis of both the goals and the objectives of the research that formed the main questions. The Likert scale rating was used as a baseline for the questions to determine individual factor from the respondents. The rating was from one to five, whereby one indicated “Strongly Disagree” and five “Strongly Agree”. This was to measure respondents’ levels of agreements or disagreements to the statements presented regarding the international market risks. The ranking covered up to the point of checking out tools and techniques that are used in measurement of the market risks and to what extent respondents know about the same.

Attaining ordinal results of the effectiveness of management techniques has been the focus of the following part. The techniques are the ones explored by the review of the literature. The goals and objectives concerning the risk management process were investigated since this is where the international market issues arise. Thereafter, there is coverage of qualitative questions for more details from respondents around their understanding of risks. It allows provision of subjective information from the respondents on risk management.

## Cronbach’s Alpha

The questionnaires used for this study were divided into three parts with different questions. Cronbach’s Alpha was used to calculate some segment of the questions and then for the entire data to determine if answers given by respondents were reliable and not for personal

reasons. The results of the calculated question using the values given by the Likert scale are shown below.

| Research Questions | Reliability Statistics | |
|---|---|---|
| | Cronbach's Alpha | No. of Questions (N) |
| What are main market risks faced and to what extent do the teams managing market risk in the international banks understand and implement risk management? | 0.63 | 3 |
| What are the most effective and efficient techniques and tools available in the banks that can manage market risks? | 0.85 | 4 |
| Are the managers and employees aware that market risks are linked to their goals and actions? | 0.65 | 3 |
| Have policies or any agreements hindered or assisted in managing risks faced by international banks? | 0.50 | 5 |
| Overall | 0.83 | 15 |

According to the calculation done using the Cronbach's alpha to the scaled question to determine reliability of the answers given by respondents, a general rule where a value greater or equal to 0.7 was implied to constrict reliability. From the answered questions, an average value of 0.83 was obtained, meaning that answers given by respondents were reliable.

In addition, the other part of the questionnaire indicated that international banks are facing market risks and are not using diverse risk management techniques. The market risk is mainly caused by exchange rate and competition risk. The international banks have not developed complex categories of risks faced in order to know that they are really dealing with them before even solving the problems (McIlroy 2008, p.98). They base their categories on the

already existing literature and only use blunt techniques and tools to mitigate and eliminate risks, instead of using strategic approaches.

**Analysis of Respondents' Results from the Initial Questionnaire Section**

The following section covers the risks that international banks face in terms of their importance in the currents banks' objectives and goals.

**Table 4.1: Main types of risks**

| Main types of risk arising from search of objectives and goals | Responses numbers | percentages |
|---|---|---|
| a. Credit risk | 19 | 95% |
| b. Exchange rate risk | 14 | 70% |
| c. Market risk | 19 | 95% |
| d. Operation risk | 17 | 85% |
| e. Concentration and Reputational | 5 | 25% |

The extremity in participants' responses demonstrates that international banks are aware, in a more informed way, the range of risks that they encounter and in a significant way they do not discount any major risks. However, some banks did not view the risks that come with the exchange rates as one of the major risks in spite the availability of evidence in literature that clearly shows that the risk is a significant issue to any bank currently (Snowden 2012, p.77). This implies that there is a blind spot created due to lack of full international development and exposure to some of the banks in the market system.

**Table 4.2: Respond result on objective two**

| Issues in terms of their importance in current objectives and goals | Response number | Mean | Percentage | Standard deviation |
|---|---|---|---|---|
| a. Public sector market increment | 1 | 3.90 | 5% | 1.40 |
| b. Profits increment | 15 | 4.25 | 75% | 1.31 |
| c. Market share increment | 7 | 3.15 | 35% | 1.14 |
| d. Expansion to new market | 1 | 1.36 | 5% | 0.96 |
| e. Efficiency improvement | 5 | 3.09 | 25% | 0.97 |

| f. Costs reduction | 12 | 3.56 | 60% | 0.95 |
|---|---|---|---|---|

Responses to the questions indicating a concentrated focus on profits increments recorded a mean of 4.22. Another strongly realised factor was need for reduction of costs, which can be related to financial performance at a higher platform of relation. Nevertheless, the need for an upgrade of market share received an upper arm in ranking indicating that several international banks may be, in one way or another, putting managerial goals first followed by financial goals. Overall, there is an implication that international banking system focuses on shareholder value addition (Carreta, Farina & Schwiser 2010, p.54).

**Analysis of Risk Management Practices by International Banks**

This final section covers the risk management practices used by international banks in the financial market. It encompasses the different techniques and tools used in managing the risks and their levels of importance as held by different international bank respondents.

**Table 4.3: Risk management process rating**

| Rating the process of risk management in terms of their importance | Responses numbers | Mean | Percentages | Standard deviation |
|---|---|---|---|---|
| a. Legal liability reduction | 5 | 2.71 | 25% | 1.65 |
| b. Profit maximization | 4 | 2.85 | 20% | 1.85 |
| c. Loses avoidance | 9 | 4.50 | 45% | 1.27 |
| d. Freeing more capital as possible | 3 | 3.10 | 15% | 1.24 |
| e. To reduce exposure to market downturns | 6 | 3.70 | 30% | 1.69 |
| f. Reduction of the credit risk of loan portfolio | 12 | 4.40 | 60% | 1.55 |

As analysed, it implies that there is a misunderstanding by banks to the legitimate reason of risk management. McIlroy (2008) argues that the process of risk management should aim mainly at profit maximization by the firms. In some areas of the Middle East is seen as a relatively new factor. Therefore, many of the international banks need to improve on their

understanding of the role and usefulness of risk management in strategic business organization. Two of the factors with the strongest rankings may be indicating that management of risk is concerned excessively with only credit risk and losses figures rather than value adding entities in the business.

**Table 4.4: Rating risk management methods rating**

| Rating the methods of risk management in terms of their importance | Responses numbers | Mean | Percentages | Standard deviation |
|---|---|---|---|---|
| a. Risk elimination as much as possible | 15 | 4.31 | 75% | 1.15 |
| b. Use of hedging in controlling risk | 7 | 3.15 | 35% | 1.00 |
| c. Potential negative impact of risk minimization | 12 | 3.70 | 60% | 1.09 |
| d. Risk transfer to clients or partners | 2 | 2.00 | 10% | 0.99 |
| e. Operations diversification for single impact risk reduction | 6 | 2.70 | 30% | 1.22 |

The question results show that most international banks use method of risk elimination as the most appropriate way of controlling risks, thus having reduction of impacts. Contrarily, risk transfer and operation diversification are not valued as main method of risk elimination (International Monetary Fund 2015, p.33). In this way, they are not engaged actively in risk transfer nor risk management through diversification. Hence, it demonstrates unsophisticated ways of addressing risk and incompetent understanding of available risk management tools.

**Table 4.5: Main methods in addressing risks in business area**

| Main methods used to address different business areas | Responses numbers | Percentages |
|---|---|---|
| a. Risk elimination as much as possible | 11 | 55% |
| b. Hedging for risk control | 3 | 15% |
| c. Minimizing potential risk negative impact | 5 | 25% |
| d. Risk transfer to clients or partners | 0 | 0% |
| e. Operation diversification for single risk impact reduction | 2 | 10% |

Considering the issue of risk management, the study reveals that elimination and risk minimization dominates the system. The lowest number of respondents, 3 out of 20, actively manage risks were through hedging and diversification.

**Table 4.6: Most effective tools and techniques**

| Which techniques and tools available are the most effective for international bank risk management | Responses numbers | Mean | Percentages | Standard deviation |
|---|---|---|---|---|
| a. Risk elimination as much as possible | 12 | 3.73 | 60% | 1.45 |
| b. Use of hedging in controlling risk | 4 | 3.30 | 20% | 1.00 |
| c. Potential negative impact of risk minimization | 13 | 3.73 | 65% | 0.93 |
| d. Risk transfer to clients or partners | 2 | 1.64 | 10% | 1.04 |
| e. Operations diversification for single impact risk reduction | 10 | 2.98 | 50% | 1.05 |

Moreover, the results beef up the essence of primarily international banks focusing on minimizing and hedging risk, which are the methods observed as the most successful in the system. There are also indications that operation diversification and hedging successfully work as risk management approaches which should be used more often (International Monetary Fund 2015, p.44). The tools may be used across the globe to give a relationship between international banks in terms of risks faced. In addition, confusion on the type of information to be acquired during an investigation of market risks may be avoided.

**Table 4.7: Resources requirements for tool and techniques**

| Which techniques and tools available require huge amount of resource to implement | Responses numbers | Mean | Percentages | Standard deviation |
|---|---|---|---|---|
| a. Risk elimination as much as possible | 6 | 2.73 | 30% | 1.51 |
| b. Use of hedging in controlling risk | 7 | 3.30 | 35% | 1.00 |
| c. Potential negative impact of risk minimization | 9 | 3.33 | 45% | 1.01 |
| d. Risk transfer to clients or partners | 9 | 3.24 | 45% | 1.54 |
| e. Operations diversification for single impact risk reduction | 5 | 2.10 | 25% | 1.47 |

The results also indicate, from a resource view, that the efficient and effective way of reducing risk are hedge usage, minimization of negative impacts and transferring risk to clients.

In contrast, risk elimination is in dire need of resources. This means that, a good number of international banks are not using risk management resources and budgets to their own benefit because they are focusing extremely on risk elimination. This clearly indicates that there is poor understanding of risk management practices since most international banks do not use method of transferring risk to clients or partners.

**Table 4.8: Tools and techniques financial impact**

| Which techniques and tools available are the most effective for international bank risk management | Responses numbers | Mean | Percentages | Standard deviation |
|---|---|---|---|---|
| a. Risk elimination as much as possible | 8 | 3.15 | 40% | 1.45 |
| b. Use of hedging in controlling risk | 3 | 2.54 | 15% | 1.14 |
| c. Potential negative impact of risk minimization | 9 | 3.15 | 45% | 1.20 |
| d. Risk transfer to clients or partners | 6 | 2.70 | 30% | 1.65 |
| e. Operations diversification for single impact risk reduction | 10 | 3.11 | 50% | 1.44 |

In fact, yet again the information emanating from the analysis is that most international banks do not utilise fully the most efficient management risk operations. In an overall process of risk management, very few respondents referred operation diversification as their foremost management risk method.

## Conclusion

In general, international banks conclude that one of the core factors in financial market is management. Moreover, different international banks face different levels of risks experienced in the financial market system. Even though they are at different levels, the problems faced are mostly the same.

From the summary, the different results from the questions clearly indicate that international banks are facing various market risks and are not employing diverse practices to

manage these risks. The international banking sector has not developed more complex categories of risk that emerge majorly in the bank can only be found in the literature. Risk management techniques and tools used by international banks are also not relatively effective. Most of them are unsophisticated and bank managers lack an understanding about the tools that can help manage risks fully. Therefore, these international banks normally use and focus on blunt techniques and tools when mitigating and eliminating their market risks instead of using advanced strategic techniques. International banks therefore need to make an extra effort to research on the best and effective methods, such as understanding the credit risk portfolio, to manage the various inevitable market risks (Lang & Nayda 2008, p.12).

# CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

## Overview

The study examined the types of market risks facing international banks, risk management practices used and their importance in the operations of international banks. Qualitative and quantitative analysis was used to analyse the data obtained from questionnaires. The three-month study should be repeated in the future to investigate if international banks are willing to change or are still repeating their old ways of dealing with market risks. This section provides a summary of the results regarding the three main objectives that formed the research questions. It also offers recommendations that international banks should consider when managing their market risks.

## Summary of Research Results

From the question on which market risks do international banks face and how does the management team understand and mitigate these risks, the study shows that international banks are faced with market risks related to liquidity, interest rates and foreign exchange. Additionally,

the management team has limited capabilities regarding implementing and understanding the market risks. Therefore, the risk management team only focused on eliminating and reducing the actual risks instead of employing strategic risk management approach such as using partners and coming up with diverse strategies of dealing with risks. Therefore, it means that international banks concentrate more on operational approaches when managing risks, rather than advanced strategic approaches that literature recommends such as using credit risk portfolio to find the existing gaps that are likely to cause problems.

The use of unsophisticated approaches is supported for two reasons, the first being that some international banks, especially those that are still advancing have no access to skilled resources needed to implement complex and strategic risk management techniques; thus only use simpler approaches to eliminating and mitigating market risks. Secondly, some international banks are not large and their market risks are operational. It implies that international banks do not see the need to employ strategic risk management techniques; thus, their inadequate capability hinders the expansion of international banks and disadvantaged when addressing market risks strategically; thus, the risks keep reoccurring and affecting the daily operations of the international banks.

Moreover, when it comes to the most effective and efficient techniques and tools that international banks have for managing risks, the literature is clear. Various techniques and tools are mentioned such as hedging by Abraham (2008), analysis of value at risk by Leong (1996), risk mitigation by Carey (2001) and diversification by Oldfield and Santomero (1997). Persuasive arguments for the above tools are provided by the study literature available with explanations for how they can be integrated into a holistic strategy for managing market risks. However, international banks provide relatively scant evidence on effectiveness of the

techniques and tools. The effective tools that international banks use for managing risks are diversification and designing action plans and implementing management plans and decisions for risks identified. It reflects that international banks are not sophisticated since they do not use cost-benefit analysis even though they support the techniques and tools mentioned in the literature.

Additionally, based on cost, international banks are efficient in risk mitigation and hedging; implying that risk management can be more effective when a balanced and sophisticated approach is employed, instead of employing just a specific technique or tool of risk management. International banks therefore need to diversify their techniques and tools of managing risks and not relying on some few practices.

Consequently, on the question about, whether international banks are aware that their goals and actions are associated with the market risks, the study found that the banks are not aware that their risks are associated with banks activities. There is a disconnection between the awareness levels of risks faced across international banks and the way responsibility, accountability and understanding helps in achieving awareness. There also lack of connection between financial stability and awareness of role of risk management. However, international banks are aware of the different market risks that they face, but do not handle them in the best way. The reason for the disconnection was the possible systematic global shifts and crisis that affect international banks. With increased market share, banks are affected by exchange rate risk, implying that international banks are only focusing on expanding and not considering that they are increasing the extent of market risks. Therefore, expanding the market share should go hand in hand with expansion of risk management techniques, so that when new market risks emerge, they have effective methods of dealing with them.

**Conclusion**

From the research, it is evident that international banks are facing market risks and are not using diverse practices of managing risks. Generally, the international banks only see operational risk, market risk and credit risk as equally important instead of categorising the major market risk and deal with it using strategic approaches. The banks also lack sophisticated tools and practices that can effectively manage risk. They rely on short-term focus that hinders expansion and success of the global banking industry in the end. For this reason, I recommend that the international banks use sophisticated and strategic tools and practices to manage market risk. Additionally, a similar study should be carried out to evaluate if effective risk management practices are deal with market risks.

# CHAPTER SIX: RECOMMENDATIONS

**Overview**

This recommendation section is organized into four parts with the first exploring on initiatives that improve transparency, quality and effectiveness of credit assessments of counterparty. The second part assesses the techniques for improving elements of measuring internal risk, information flow and management with the aim of improving decision-making and risk awareness in individual firms. The third part focuses on features of common practices and conventions in the market that can facilitate management of credit risk of counterparty if improved when dealing with distraught counterparties. The last part explores on various limited initiatives for improving timeliness, relevance and quality of information flowing between primary regulators and major participants in the market.

The recommendations represent a set of comprehensive proposals, in which international banks can build upon improvements of risk management techniques that already exist. Therefore,

many of the recommended practices may be already in use in various firms even when they do not utilise them all. The recommendations are meant to reflect better ideas for enhancements and bring out creative interaction among the various skilled professionals working in the various international banks in the world. Generally, I believe that the recommendations will act as the basis for great enhancement of practices for managing market risks; thus help in strengthening market discipline associated with market and counterparty risk management. Below are four main recommendations for better risk management in international banks.

**Recommendation 1: Improve Counterparty Credit Assessment and Transparency**

International banks should focus on three aspects of the process of managing counterparty risk. They include sharing information between credit users and credit providers, arranging confidentiality to ensure client’s proprietary information is properly handled and improving quality and transparency when understanding interplay between leverage, market risk and their impacts on the creditworthiness of the counterparty (Dowd 2005, p.78). On the aspect of sharing information, international banks should consider quality, timeliness and quantity of the shared information between credit providers and users. There should be flexibility when moving along the continuum in assessing the degrees of credit terms and availability. Credit users’ concerns on how creditor firms use their information are an important obstacle when it comes to information sharing. The concerns are normally the possibility that the information may leak into the market.

Therefore, information confidentiality is an existing issue in the financial and banking sector. The issue sometimes becomes complex when the nature of credit users and credit providers’ relationships become intensely competitive and when there are improvements in the integration of credit and market risk management and in internal risk transparency. In these

situations, it increases the chances of making client information available to the outside ranks that make credit decisions.

Leveraged investors and financial intermediaries today are using more than one variation methodologies of Value at Risk (VAR) to monitor, limit and estimate market risk. VAR is an estimate of possible change portfolio's value after adverse market shocks. However, VAR estimates have some limitations due to assumptions used for market parameters, liquidity and market normality (Eijffinger & Masciandaro 2011, p.37). Therefore, VAR users supplement the estimates with stress tests to provide better estimates. One should leave the market participants to determine, which appropriate methods they want to combine to measure market risks. Financial institutions should prepare comprehensive and regular estimates of the market risk and be applied across the trading portfolios (El-Erian 2008, p.67). Key credit providers should prepare the estimates using the appropriate information and methodologies and update the information periodically.

**Recommendation 2: Improve Counterparty Risk Management, Reporting and Estimation**

Risk analysis allows banks to estimate and manage market risks by implementing better credit practices such as hedging, analysis of Value at Risk and risk mitigation. Unresolved market risks can cause shocks in the market, leading to occurrence of consequences such as a sudden reduction in market liquidity, sudden loss of adequate collateral and blurring of credit and market risk distinctions (Greuning & Iqbal 2008, p.54). These consequences normally have considerable implications on the practices of managing counterparty risk.

Current exposure is the current value in the market of receivable or payable derivatives and is called the cost of current replacement. Potential exposure is an estimated cost of

replacement in the future. Such estimates are important when counterparty is exposed to illiquid or large exposures. Therefore, information about the current replacement value should supplement the estimate of the replacement value based on liquidation. Financial institutions should improve their monitoring capabilities and set appropriate limits for exposure measures.

Testing credit and market risk stress is important, but the techniques consume time and resources. To make testing of the stress meaningful, risk managers should construct modified stress scenarios that investigate the weaknesses of the portfolio (Ghosh 2012, p.56). This techniques indicates how much the financial institutions can lose and what can make them lose even more. Firms should test economic impacts of stress events on trading portfolios as well as investment and credit portfolios.

**Recommendation 3: Improve Market Conventions and Practices**

International banks should evaluate opportunities that can improve risk management by improving the general market conventions and practices. The banks can achieve this improvement by improving documentation of practices and policies, focusing on timeline issue. They should also improve documentation of content, focusing on valuation and closeout issues. Additionally, they should also improve the collateral management techniques (Heffernan 2005, p.45).

These recommendations aim to attain two objectives. The first is to improve the ability of the creditor to deal with failing or distressed counterparties effectively and on time. Secondly, the recommendations aim at enhancing the capacity of the market to have leveraged participants such as end investors and intermediaries who have risk in failures. The banks should enhance close-out mechanisms for standard industry (Holzmann 2009, p.87). The market should have

closeout arrangements, which generate valuations that are commercially reasonable and are implemented quickly despite stressful conditions in the market. The closeout arrangements should have legal certainty in the end claims.

In international financial markets, operations are thoroughly interconnected sets of contracts of market participants reaching from global investment and commercial banks to unite end users and individual investors. Written documents are necessary when establishing a contract and act as an important evidence of terms in the agreement as well as the specific terms agreed by all parties before a transaction (Churchill & Frankiewicz 2006, p. 53). However, risk is created when the involved parties fail to document the transaction appropriately.

International banks can control documentation risk with strong practices and adequate staffing. The benefits of these practices effectively reducing time between codification when writing the trade and trade date. The second benefit is that the process of documentation allows parties to discuss issues that are irrelevant when negotiating but can be of importance when a dispute arises (Kusek & Rist 2004, p.67). Thirdly, documentation provides a framework where parties can agree upon various issues in a peaceful manner. Additionally, the process allows parties to discuss the legal relationship between the codification of the relationship and the parties involved prior to occurrence of problems.

**Recommendation 4: Regulatory Reporting**

Lack of regulatory information by international banks can lead to challenges of managing market risks as the information gives updates on market conditions and trends. In this case, International banks should consider regulatory reporting that could improve the timeliness and quality of available information in regulatory authorities. The objective of reporting is to

facilitate sharing of qualitative information on time on market trends and conditions (Cavusgil 2009, p. 46). The other objective is to respond to the expressed desire to assist in the regulatory monitoring of developments regarding the management of counterparty credit risk since they relate to subjects and issues in the report, especially on issues of risk concentrations and leverage. In this way, would assist in investigations that are concern with risk management practices used by international banks to deal with market risks.

To meet these two objectives, international banks should be guided by some basic principles. The first principle is that the most important source of consistent information should be relevant information that senior management get from their firms (Ledgerwood, Earne & Nelson 2013, p.34). The second principle is consolidation of any consistent source of information, which should be from a group and not a collection of several legal entities in a group for tax and regulatory purposes. Information should be taken to the principal regulator of the group.

Thirdly, managing market risks requires one to use the information from the internal management and consider the best qualities such, flexibility, timeliness relevance and affordable costs. It should also accept differenced in limitations and methodology in collecting information that is not comparable (Bessis 2014, p 20). Fourthly, accessing information from the internal management requires regulators to be disciplined on the part of limiting tendencies that interfere with matters, but the management should be allowed to make decisions.

Information providers should provide clear understandings about how regulators can share and use the information. Additionally, making information available to regulators is two-sided because they have the information that lacks proper means of evaluating it or power to act

on the information (Malz 2011, p.73). Therefore, unrealisable expectations can be created outlining how regulators can contain or prevent problems. International banks should regularly report to the regulatory authorities to avoid problems that can lead to market risks. Moreover, the aspects help in market risk management because of a pool of related information on different inter-twined risks.

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# APPENDIX A

Questionnaire

Part I

| **Bank:** |
| --- |
| **Occupation:** |
| **Date:** |

Part II

Rate each of the goals of your risk management practice in terms of their significance.

Use the scale of 1 to 5, where five is the most important.

| | |
| --- | --- |
| a. To maximize profit | |
| b. To reduce the legal liability | |
| c. To reduce the exposure of market downturns | |
| d. To avoid making losses | |

| | |
|---|---|
| e. To reduce credit risk on your loan portfolio | |
| f. To open up as much capital as possible | |

2. Rate each method in your risk management process in terms of their significance. Use the scale of 1 to 5, where five is the most significant.

| | |
|---|---|
| a. Transferring risk to the clients or partners | |
| b. Eliminating risks | |
| c. Minimizing the potential negative influence of any peril | |
| d. Using hedging to manage the risk | |
| e. Diversifying the operations to reduce the impact of any single risk | |

3. Which of these techniques and tools accessible to your bank for the managing of risk require most resources to put into practice successfully? Rank the subsequent in order of resources needed, from the most to least where one is most resources and five is least

| | |
|---|---|
| a. Transferring risk to the clients or partners | |

| b. Eliminating risks | |
|---|---|
| c. Minimizing the potential negative influence of any peril | |
| d. Using hedging to manage the risk | |
| e. Diversifying the operations to reduce the impact of any single risk | |

4. What are the major types of risk that arise from your quest of your strategic objectives and goals? Choose all that apply

| a. Market risk | |
|---|---|
| b. Credit risk | |
| c. Exchange risk | |
| d. Operational risk | |
| e. Other (Specify) | |

Part III

On a degree of 1 to5 (where 1 indicates “Strongly Disagree” and 5 indicates “Strongly Agree”), rank the extent that you agree with the following accounts:

5. There is an ordinary understanding of peril management across the banks__________

6. Accountability of risk administration is clearly set out and understood across the banks________

7. The management of risk makes an important contribution to the achievement of the banks _____

8. Your bank comprehends the peril management systems utilised by other banks, their benefits and costs_______

9. Your bank gets important steps to keep up to date with present risk management trends_______

10. The bank finds it hard to prioritise and identify its key risks_______

11. Describe your perception of peril management as completely as possible. Refer back to previous answers if applicable.__________________________________________________