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Abstract

This paper builds upon prior work conducted by Joint Forum working groups in the area of risk integration and aggregation and aims to explore the progress that financial conglomerates have made in identifying, measuring, and managing risk concentrations on a firm-wide basis and across the major risks to which the firm is exposed.

In December 1999, the Joint Forum published its *Risk Concentrations Principles*, which provided supervisors with principles for ensuring through the regulatory and supervisory process the prudent management and control of risk concentrations in financial conglomerates. In November 2001, the Joint Forum published *Risk Management Practices and Regulatory Capital: Cross-Sectoral Comparison*. This report noted a trend towards convergence of sectoral approaches to risk management and capital, while remaining neutral as to the extent to which such convergence would increase in the future. The Joint Forum's August 2003 publication, *Trends in risk integration and aggregation*, observed two important trends: (i) a greater emphasis on the management of risk on an integrated firm-wide basis; and (ii) related efforts to aggregate risks through mathematical risk models. However, the 2003 paper noted that firms varied considerably in the practical extent to which important risk management decisions were centralised and that risk aggregation methods were in the early stages of development.

This paper expands on the previous reports and explores the extent to which financial conglomerates active in two or more of the banking, securities, and insurance sectors currently identify and manage risk concentrations at the firm-wide level and how current and emerging risk techniques, including stress testing and scenario analyses, are employed to identify potential concentrations.

Joint Forum notes that the bulk of the work undertaken in compiling this report took place before the market turmoil in the latter half of 2007. Specific comments on these events are set out in the boxes on pages 13 and 32 but the report is focused on the management of risk concentrations more generally.

The Joint Forum notes that risk concentrations at most financial conglomerates are still chiefly identified, measured and managed within separate risk categories and within business lines. For instance, credit exposures are considered within banking business units, catastrophe risk concentrations within an insurance business unit and so on. We characterise this as 'silo management'.

The report makes two other broad observations: first, when compared with other risk types, the management of liquidity risk tends not to be as well integrated in a scheme of cross risk analysis (probably because it is not measured in the same way as other risks); and second, insurance-led conglomerates seem to be somewhat more experienced in undertaking the design of integrated cross risk scenario analysis, perhaps because the nature of insurance business risks, particularly in the property and casualty business, are less readily amenable to linear analysis.