WHITE PAPER

JASPER COLIN

Stabilize or Sink?

Market Movers Face Terrifying Decisions to Restore Confidence Post Banking Failures

APRIL 2023

This paper analyses the warning bells that are ringing across the financial industry following the busting of three significant American mid-sized banks, each with more than a billion-dollar deposit base.

FIRST REPUBLIC BANK

90% crash before bail-out

svb

60% crash in two weeks

Signature

40% crash post SVB collapse

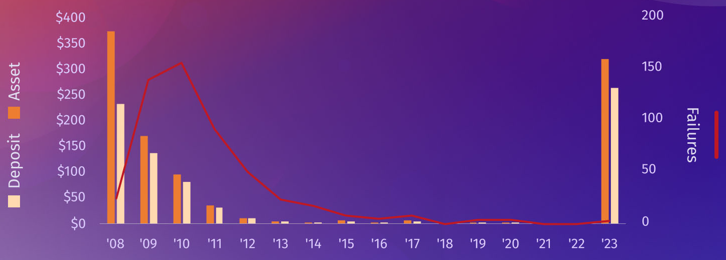
The banking industry is in crisis, as the assets exposed in the two biggest bank failures since Global Financial Crisis (GFC) have already crossed 85% of those exposed in the 25 bank failures of 2008. With increasing interest rates and deposit withdrawals, the entire US banking system is at risk of collapsing.

The recent collapse of **Credit Suisse** due to internal and external factors has sent shock-waves across the global banking sector, leaving **Deutsche Bank** vulnerable and sparking widespread speculation about its financial stability.

Depositors are terrified about the safety of their funds in the unsafe vaults of financial institutions, raising serious questions about the future of the industry.

US banking failure since 2008

Total assets in 2023 bank failures catching up to 2008 (All in $Billion)



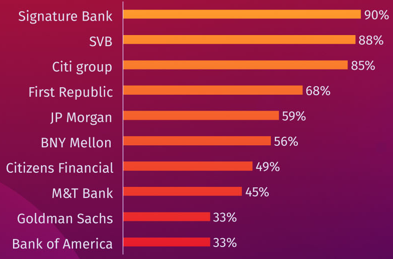
HAUNTING REALITY

BANK FAILURES EXPOSE CRACKS IN THE SYSTEM

Will they widen into unbridgeable chasms?

Market analysts are perplexed by the absence of regulatory controls on the substantial non-FDIC insured deposits in smaller banks, which contributed to the recent liquidity crises. Fraudulent management through insider trading and the lack of a risk management framework exacerbated the troubles for financial institutions. To make matters worse, Fed's aggressive rate hikes in 2023 in order to contain inflation forced banks to raise interest rates for depositor retention.

% of Uninsured deposits among financial institutions



40%

of US bank deposits are uninsured, amounting to an exposure of $9.2 Trillion

$55Bn wiped out for **4 largest US banks** within 24 hours as stocks crumbled like a pack of cards

Doomsday on the horizon?

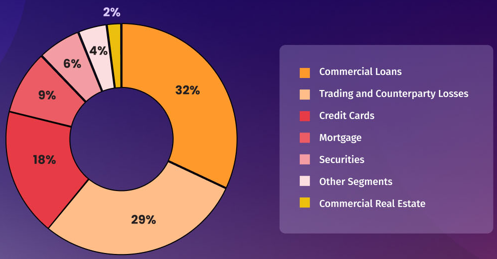
Experts warn of impending risks and challenges for the financial sector

Jasper Colin team **interviewed over 40 Chief Risk Officers and Financial Consultants** from regional and global banks to better understand the value of a strong risk management framework and how its absence contributed to the demise of the three largest regional banks in the US.

1. Technology Risk

A Banker's Perspective: According to Top US Banking Executives interviewed, the segments which would face the maximum challenges owing to tech inadequacy vis-a-vis risk modelling are -

Banking Segments at Risk by 2025



Source: Jasper Colin's Sentiment-o-Meter

2. Investment and Credit Risk

Companies with weaker balance sheets, still reeling from the pandemic shock and facing supply chain bottlenecks, could pose higher default risk for lenders.

Regional banks with less than $250 billion in assets account for

50%

of all commercial and industrial (C&I) loans

70%

of commercial real estate loans

38%

of residential mortgages

To retain deposits, banks need to increase the interest rates they pay depositors in the rising interest rate environment, which has squeezed bank profit margins.

Robust AI-driven credit risk management framework would likely assist banks in **predicting deposit outflows, borrower's capacity to repay loans, and identifying at-risk clients** to avoid further disasters for smaller banking institutions.

3. Systemic Risk

> *With financial innovations of complex structured assets, technological advancements and macroeconomic volatility attacking the banking sector with the holy trifecta of instability, the industry can no longer afford to just deal with the cards as they are being given.*

Investment Banking Risk Professional

Jasper Colin's Banking Experts Panel Transcripts

Investment and Credit Risks: → Slightly High

Market & Systematic Risks: → Moderately High

Model & Tech Risks: → Severely High

Need of the Hour

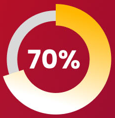
Implementation of an AI and Machine learning driven risk management model to endure regulatory changes and macro-shocks

As per Jasper Colin's US Banking & Capital Markets Survey 2023

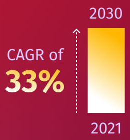
A whopping

75%

of I-Banks exhibit "low confidence" on their risk compliance divisions amidst a volatile backdrop of 2023; implying AI is no longer just a theme for sci-fi movies or talking robots



of Financial Institutions believe that AI adoption has better prepared their organization to **deal with systemic risks and cybersecurity threats** that were previously untracked.



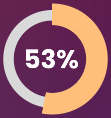
AI backed solutions in the banking sector are estimated to reach **>$64 billion by 2030**, at a CAGR of 33% since 2021.

AI Investments payoff : financial institutions reaping business benefits with

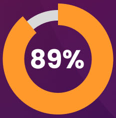
> 90% seeing essential outcomes

> 10% growth in yearly revenues by over 10%

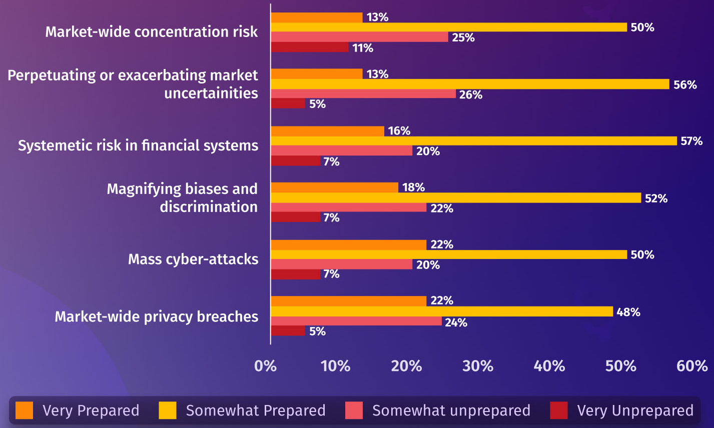
> 10% reduction in costs



of the technology investments by top banks relate to **risk and compliance**



of the technology investments by top banks relate to **cybersecurity and information security**



Is there a light at the end of the tunnel?

Interviews with 70+ risk executives in Corporate and Retail Banks suggest there are
4 pillars of a Successful Strategic Risk Framework of Future
that are crucial for managing risks as we move towards 2030.

4.2

Responsible AI & Tech Partnerships, backed by strong vendor assessments

4.3

Back Testing & Modelling for Diversification and Hedging

4.1

Data-centric Strategy for Effective Implementation

4.4

Rigorous Monitoring & Impact Assessment

4.1

DATA-CENTRIC STRATEGY FOR EFFECTIVE IMPLEMENTATION

To implement a data-centric strategy effectively, banks should prioritize the following:

1. Establishing a clear understanding of the data they have and need,
2. Ensuring data quality and governance,
3. Leveraging advanced analytics and AI to gain insights and make data-driven decisions, and
4. Prioritizing the protection of customer privacy and data security.

By focusing on these key areas, banks can unlock the full potential of their data, driving innovation and competitive advantage while minimizing potential risks.

4.2

RESPONSIBLE AI & TECH PARTNERSHIPS, BACKED BY ROBUST VENDOR ASSESSMENT

To ensure responsible use of AI and effective risk management, banks should prioritize partnerships with tech vendors that prioritize ethical and transparent AI practices. This can be achieved through a robust vendor assessment process that evaluates factors such as data privacy, and bias mitigation, among others.

Such partnerships can help banks to leverage the benefits of AI while minimizing potential risks and maintaining compliance with regulatory requirements.

4.3

BACKTESTING & MODELING FOR DIVERSIFICATION AND HEDGING

An AI-enabled back-testing and modelling system can help banks to diversify their portfolios and hedge against potential risks. By analyzing vast amounts of historical data and using machine learning algorithms, the system can identify patterns and make predictions on market movements, enabling banks to make informed decisions on portfolio composition and risk management strategies.

This can result in better risk-adjusted returns and increased stability in the face of market volatility.

4.4 RIGOROUS MONITORING & IMPACT ASSESSMENT

To ensure effective monitoring and impact assessment in banks and capital markets, it is essential to implement a rigorous framework that includes the following:

1. Establishing clear performance metrics and KPIs that align with strategic objectives,
2. Leveraging advanced analytics and AI to track and analyse performance data in real-time,
3. Conducting regular impact assessments to identify potential risks and opportunities, and
4. Maintaining transparency and accountability through regular reporting and stakeholder engagement.

By prioritizing these elements, banks and capital markets can ensure that their operations remain aligned with strategic objectives while minimizing potential risks and maximizing positive impact.

Key Takeaway

In essence, with Global Financial Markets becoming more unpredictable by the day, inter-linked with disruptions across ever-changing Geo-Political, Regulatory, Technology landscapes and continuous innovation across sectors, the need to have access to real-time, hard-to-find FS insights is at unprecedented levels.

The current crisis is a wake-up call for the financial ecosystem. **It is time for the industry to hunt for the partners who possess the right data, subject matter expertise, and industry insights.** Now is the time to prioritize this effort and take decisive action, as the future of the industry hinges on the decisions made today.

Whitepaper Methodology & Approach

As the financial sector braces for macroeconomic uncertainty and regulatory challenges, Jasper Colin team developed a hybrid framework based upon primary and secondary market research, deploying end-to-end market surveys with banking & capital market professionals, and focussed discussions with KOLs and SMEs .

01

TRACKING CAPITAL MARKET MOVEMENTS

The chaotic market conditions characterized by **drastic changes in the macroeconomic landscape including inflation, Fed's aggressive interest rate hikes, and inadequate regulation have led to the downfall of regional banks** in a succession. Jasper Colin's Capital Monitoring tool has been instrumental in tracking impending market volatilities and the regulatory hurdles that are likely to stymie financial industry expansion in 2023.

Jasper Colin's Market Watchdog *further assisted in gathering insights macroeconomic and various other compliances and threat monitoring indicators*

02

UNEARTHING THE UNFORESEEN GAPS IN THE TECH INFRASTRUCTURE

Regional banks had to pay a **hefty fine to regulatory bodies from the rising fraud and cybersecurity issues due to deficient technology infrastructure.**

Jasper Colin interviewed **80+** Chief Technology Officers from global FIs to gain a better understanding of the function of a strong technological foundation in dealing with fraudulent incidents that undermine depositor confidence.

03

SOLVING RISK FRAMEWORK PUZZLE

Recent banking failures pointed out **lacking risk management frameworks that failed to address the high exposure to uninsured FDIC deposits and declined treasury bond market activity** due to rate hikes causing liquidity and deposit crunch.

We combined our data from industry experts with Jasper Colin's ***PitchPro*** *to gain a comprehensive understanding of how to further assess the risk management framework at an entity level to be able to withstand future market uncertainties.*

04

UNDERSTANDING THE PRIVATE INVESTMENT LANDSCAPE

As liquidity crunches and deposit losses keep FIs bleeding, private funding remains an important source for capital raising. Jasper Colin teams interviewed leading investment experts from global Fund Houses to gain valuable insights into general investor mood and trust in the financial sector. The focused discussions centred around many of the critical issues including technology investment, dry powder, and investing preferences. *A real-time tool for business analysis, deal tracking, investment research, and transaction advising was developed for global fund houses using advanced data analytics techniques and in-house Track Companies capabilities.*

Optimize your Risk Management function by accessing Jasper Colin's unmatched FS Insights & Analytics from Global FS Community of KOLs, Sector Experts and Premium Financial Markets Data Sources.

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