DegreeLive Logo

B.Com Honours | Semester V | Calicut University

ESSENTIALS OF INVESTMENT BANKING OPERATIONS

Course Code: COM5EJ316 • Module 4 Notes

Module IV: Introduction to Risk Management in Investment Banking

Covers risk taxonomy in investment banking, Comprehensive Capital Analysis and Review (CCAR), Dodd-Frank Act Stress Testing (DFAST), and Recovery & Resolution Plans (RRP).

Unit 14: Risk Taxonomy in Investment Banking

Core Risk Categories:
1. **Market Risk:** Losses from price movements (Equity, Interest Rate, FX, Commodity risk).
2. **Credit Risk:** Counterparty default risk on OTC trades & loans.
3. **Liquidity Risk:** Inability to meet cash settlement obligations.
4. **Operational Risk:** Failures in internal systems, human errors, or trade processing breaks.

Unit 15: Comprehensive Capital Analysis and Review (CCAR)

CCAR Framework: Annual Federal Reserve regulatory exercise evaluating whether large bank holding companies have robust capital planning processes & sufficient capital to absorb losses during severe recessions.

Unit 16: Stress Testing & DFAST Framework

DFAST (Dodd-Frank Act Stress Testing): Quantitative forward-looking capital assessment evaluating bank resilience under Baseline, Adverse, & Severely Adverse macroeconomic scenarios (e.g. 10% unemployment, 50% stock market crash).

Unit 17: Recovery and Resolution Plans (RRP / Living Wills)

RRP / "Living Wills": Mandatory blueprint detailing how a Systemically Important Financial Institution (S-IFI) can be rapidly & orderly dissolved under bankruptcy without requiring taxpayer bailouts or destabilizing financial system.

Practical Case Framework 1 (Investment Banking Risk Taxonomy & Mitigation Matrix): Detail risk category, operational origin, measurement metric, and mitigation control tool.

Risk Taxonomy & Mitigation Framework Table:

Risk Category	Operational Risk Origin	Primary Measurement Metric
Market Risk	Adverse asset price & yield movements	Value-at-Risk (VaR 99% confidence level)
Credit / Counterparty Risk	Derivative counterparty default	Potential Future Exposure (PFE) & Credit Valuation Adj (CVA)
Operational Risk	Trade settlement breaks & system failures	Key Risk Indicators (KRIs) & Loss Data Collection

Practical Case Framework 2 (CCAR vs DFAST Regulatory Comparison Matrix): Compare regulatory mandate, capital distribution assessment, qualitative review, and disclosure rules.

CCAR vs DFAST Regulatory Framework Table:

Regulatory Framework	Capital Distribution Assessment	Qualitative Review Focus
CCAR (Federal Reserve)	Evaluates proposed capital actions (Dividends & Buybacks)	Assesses internal risk governance & capital planning
DFAST (Dodd-Frank Act)	Standardized quantitative capital ratio projections	Focuses purely on quantitative scenario stress tests