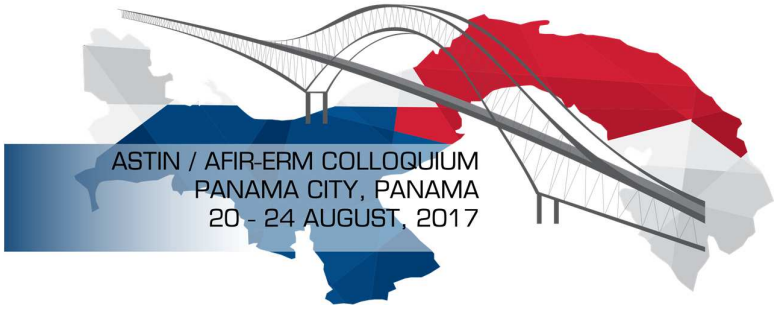

SYNOPSIS

TITLE Do Risk Managers believe in Stress Testing outcomes?

AUTHOR(S) Ricardo Tagliafichi

Key words: Credit Risk Market Risk Liquidity Risk Interest Rate Risk Operational Risk

Purpose of your paper: to develop models that include the Risk Managers' believes or the Macroeconomic Expert's judgment.

Synopsis: Abstract

When remembering the controversy between the "quants", who base their predictions on a model developed under the concept that the future comes from the past and pass through the present, and the professionals who base their decisions on subjective degrees of personal beliefs… I convince myself that the question that entitles this job is a reality.

In order to provide an alternative answer for this question I propose to develop models that include the Risk Managers' believes or the Macroeconomic Expert's judgment. In this way I suggest to analyze several risk models that combine a quant model and the Risk Managers' beliefs.

The risks we need to analyze with the proposed models are the following:

- Credit Risk: besides the traditional model PD*EAD*LGD, I recommend to include in the analysis the behavior of the default rate and its impact on the EAD, the incidence of Vasicek model and the relationships among default rate, GDP growth rate and unemployment rate.
- Market Risk: is necessary to develop a model that shows the static and dynamic behavior of each variable under study.
- Liquidity Risk: the model needs to contemplate both types of liquidity risks, the liquidity risk resulting from the market conditions and the liquidity risk derived from the Entity's specific conditions and characteristics.
- Interest Rate Risk: the inclusion of the series' behavior and volatility analysis and the relationship among them and the macroeconomics series are necessary for the model to be developed. The term structure is the base of the interest risk model, given that reflects the effect of inflation, market liquidity and GDP.
- Operational Risk: the model need to be based on the developments made in Insurance business, including references to the credibility theory.
- Strategic Risk: this is the more difficult risk to model due to the fact that it is necessary to include some specific business aspects as the banking interest spread, GDP, salaries and errors made on the past forecasts.

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Finally, we cannot forget the last big crisis we have experienced in 2008 that is well shown in the film named "Margin call". For this reason it is important to get on with Risk Managers and present them these credible models in order to convince both "quants" and "believers" to start using them.

Note: If you are not presenting a paper for this Colloquium, please include as much detail as possible in your Synopsis (maximum three pages) to enable delegates to prepare for your session.