



BANK OF ENGLAND

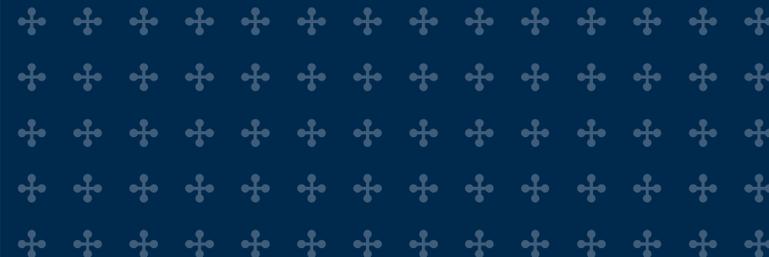


On the Origins of Systemic Risk

Discussion

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What they do

- They develop a microstructural model calibrated on a new granular dataset.
- Using a simulation engine, they try to
 - disentangle the different sources of systemic risk and
 - identify its main drivers for the Euro Area banking system.

Definitions

Systemic risk is defined as the probability of a systemic event conditional to a certain information set.

Systemic event is a scenario in which a large number of banks default in the same time period.

What they find

Common exposures to the real economy represent a source of risk for individual banks.

Systemic events are possible due to the interaction between common economic shocks, weakening banks' balance sheets and financial contagion channels.

For Q4 2018 in the euro area:

- The total probability to experience a systemic event is estimated at around 3.6%.
- Average bank default probability amounts to roughly 0.15%.

Overall...

- Very interesting paper!
 - Impressive data effort
 - Very ambitious simulation engine
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Comment 1

Focus of the paper is on identifying the determinants of systemic risk

- Aren't the determinants "predetermined" by the micro-structural model and the economic shock that is fed in? The determinants would necessarily stem from the set of contagion channels built into the model.
 - For example no repo market to turn to for more funding.
- Obviously, the weight of the individual channels are of interest too.
- Aren't the weights of the channels distorted by the fact that it is a bank-focused network?
 - No links between non-banks (which could lead to more amplification potentially)
 - No feedback to the real economy

Comment 2

Banks are well capitalized, resolution regimes are in place, there are regular (macro) stress tests.

- Are economic shocks feeding through banks still the origins of systemic risk going forward?
- Is the relevant systemic event going forward still the one where a large number of banks default in the same time period?

→ How does this impact the use of the model for counterfactual policy simulation?

Conclusion

- Great paper
- Culmination of several papers and tedious data work
- Recommend to read it