A discussion of
Chionsini, Foglia & Reedtz

"Bank mergers, diversification and risk"

Kasper Roszbach

Banking and financial stability
Rome, 22/3/2003

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Discussion of ”Bank mergers, diversification and risk”

- G-10 Consolidation in the Financial Sector:
  - ”Because the net impact of consolidation on individual firm risk is unclear, the net impact […] on systematic risk is also unclear.”
- Objective of this paper
  - Identifying the net effects of mergers on credit VaR by:
    - diversification of idiosyncratic risk
    - changing lending policy / increased risk taking
- Why important?
  - Regulation
    - banking supervision, merger policy

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- Approach
  - Merging bank portfolio’s: different risk profiles
  - Sources of default risk:
    - systematic (macro)
    - industry / regional
    - idiosyncratic
  - Semi-parametric calculation of VaR
- Insights
  - HH-index falls due to merger from 4.8/6.9 to 4.2
  - Average unexpected credit losses (99.9% VaR) fall from 2.00/3.31% to 1.87 due to “diversification”
  - Riskiness more or less unchanged 2 years after merger

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- Issues/questions
  - Credit risk model
  - Is the “concentration” effect a diversification effect or a portfolio size effect?
  - Horizon: merger effects after 2 years?
- Extensions
  - Separate diversification effect, portfolio size effect and riskiness shift
  - Generate portfolios with identical profiles to calculate pure size effect
  - Change in “risk profile” due to size or diversification?

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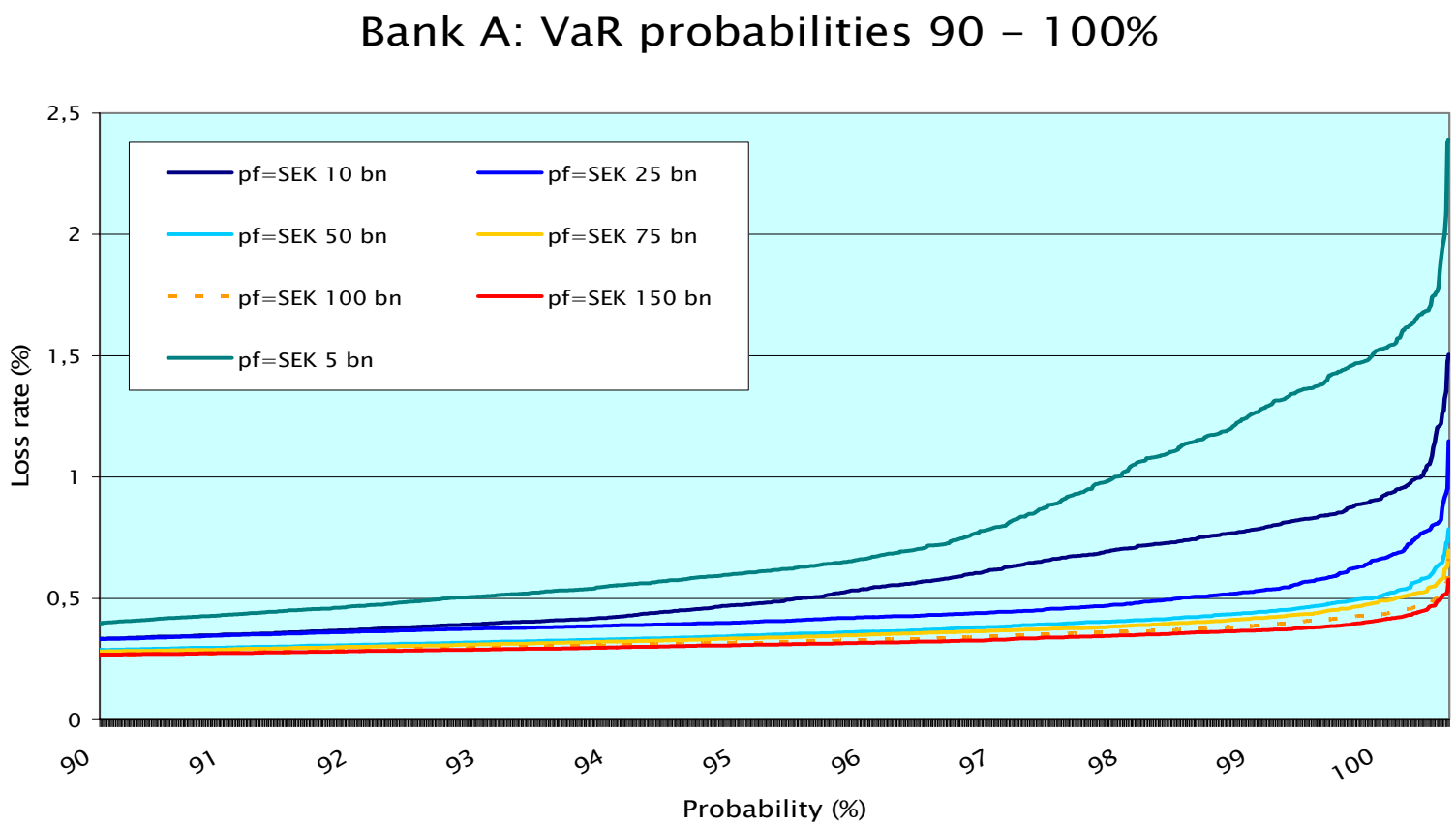

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VaR percentiles for different portfolio sizes (nr. simulated portfolios 10.000)

Size	Horizon	Value at Risk Percentiles							
(SEK bn)	(quarters)	90	95	97,5	99	99,5	99,75	99,9	99,99
5	*1*	0,095	0,159	0,236	0,400	0,502	0,551	1,342	1,484
10	*1*	0,087	0,128	0,175	0,285	0,351	0,680	0,738	0,782
25	*1*	0,068	0,102	0,132	0,224	0,323	0,336	0,360	0,633
50	*1*	0,065	0,090	0,141	0,185	0,193	0,200	0,217	0,363
75	*1*	0,064	0,089	0,124	0,137	0,149	0,228	0,246	0,262
100	*1*	0,062	0,084	0,102	0,113	0,149	0,184	0,196	0,207
150	*1*	0,063	0,075	0,083	0,125	0,132	0,146	0,185	0,201
5	*4*	0,412	0,619	1,021	1,415	1,576	1,663	1,949	2,454
10	*4*	0,342	0,502	0,706	0,839	0,927	0,997	1,170	1,354
25	*4*	0,340	0,412	0,478	0,578	0,666	0,750	0,806	0,934
50	*4*	0,293	0,355	0,408	0,471	0,515	0,569	0,626	0,728
75	*4*	0,285	0,342	0,387	0,442	0,491	0,522	0,553	0,626
100	*4*	0,273	0,323	0,363	0,411	0,437	0,468	0,499	0,562
150	*4*	0,271	0,312	0,348	0,382	0,414	0,440	0,477	0,518