DEUTSCHE BANK PRIZE IN FINANCIAL RISK MANAGEMENT AND REGULATION 2012

Malcolm Knight (Deutsche Bank and LSE)

The annual prize essay competition for LSE students' research papers in the field of financial risk management and regulation is organised by the FMG with the generous support of Deutsche Bank. The award committee for 2012 consisted of **Ron Anderson** (FMG, LSE), **Malcolm Knight** (Deutsche Bank and LSE) and **Christopher Polk** (FMG, LSE).

In judging the submitted papers the committee applied three criteria:

- The paper dealt with a substantial problem of financial risk management and regulation.
- The paper was submitted by one or more LSE research students.
- The paper exhibited the high standards of originality and rigour appropriate for a leading international research university.

Winning paper:

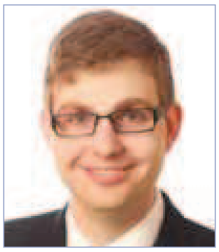
"Portfolio credit risk of default and spread widening" by **Hongbiao Zhao** a PhD student in the Department of Statistics

Prize winner
Hongbiao Zhao

The experience of the financial crisis has demonstrated the importance of developing reliable, tractable methods for studying the risks contained in portfolios of credit sensitive instruments. The pitfalls of over-reliance on a narrow class of credit portfolio models which were too quickly adopted as the industry norm by credit ratings agencies and other key institutions were exposed by the break-down of those models as the crisis unfolded in 2007 and 2008. Hongbiao has made an excellent contribution in setting out a rich framework for modelling portfolio credit risk that is at once flexible and quite practical to implement. It gives an innovative way to combine the two principal sources of information on credit sensitive instruments – market spreads on traded instruments and historical information on default, and is applicable to portfolio credit risk management, stress test, or to fit into regulatory capital requirements.

Runner-up paper:

"Systemic liquidity requirements" by **Toni Ahnert,** a member of the FMG and a PhD student in the Department of Economics



Runner-up
Toni Ahnert

Toni's paper was written jointly with **Dr Benjamin Nelson** of the Bank of England. It examines tougher bank regulation in light of the recent financial crisis, including regulation of the liquidity position of financial intermediaries. Contributing to the development of a macro-prudential tool-box, Ahnert and Nelson study the system-wide consequences of a bank's liquidity and diversification choices. They show that individually beneficial diversification, results in systemic fragility that exposes one bank to runs on other banks, generating a positive liquidity externality. Despite a perfect alignment between banks and their creditors, the competitive bank holds too little liquidity and over-diversifies relative to the constrained efficient allocation. The authors show that a liquidity buffer is welfare-improving and study the sensitivity of such a liquidity buffer to changing business conditions.