Determinants of Banks' Total Risk: Accounting Ratios and Macroeconomic Indicators

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DETERMINANTS OF BANKS' TOTAL RISK: ACCOUNTING RATIOS AND MACROECONOMIC INDICATORS

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During the recent financial crisis, 339 U.S. banks failed whereas only 24 banks failed from 2000-2007. It is important to identify how banks' operations and changes in the economic environment might influence the total risk level faced by U.S. banking institutions in order to avoid the number of bank failures experienced during the recent recession. This study analyzes publicly traded banks in the U.S. from 1980 to 2010. Various accounting ratios and macroeconomic indicators are used as proxies for the effects of individual bank operations and changes in the economic environment. Total risk, as measured by the standard deviation of ROA and ROE, is regressed against the accounting ratios and economic indicators to identify the important sources of total risk.