

# [Financial risk management - goldman sachs bank during the financial crisis](https://assignbuster.com/financial-risk-management-goldman-sachs-bank-during-the-financial-crisis/)

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The short-selling of subprime mortgage securities to Lehman Brothers is blamed to have worsened the financial crisis to the detriment of both institutions. As a result, the bank approached the federal government for a bailout under the troubled asset relief programme (TARP). Since the loan came with high-interest rates and short repayment period, the bank’s financial condition worsened and become highly geared. In summary, Goldman Sachs financial crisis can be classified as threefold, that is, financial malpractices among traders and top executives in trading mortgage securities (operational risk), mortgage industry crisis/ risks and high financial leverage.

Risk management theories that can be used to explain the crisis an offer insights into possible solutions are discussed hereunder. Weinberg (2007) noted that the bank relied on incomes from trading to maintain its profit growth which was risky. Therefore, the bank should have maintained a prudent model to monitor the value at risk (VaR) for securities being traded. VaR model shows the maximum estimated loss for a portfolio factoring market-related risks at a given time horizon (Esch, Kieffer and Lopez, 2005). Capital Asset Pricing Model (CAPM) would also have helped the bank to understand the behaviour of capital markets and possibilities of excess, negative and optimal return on a portfolio by analyzing the securities market line (Elton et al., 2010). Brownian motion model of financial risk management though highlights useful risk strategies useful under normal circumstances was found to fail in providing a rational understanding of financial turmoil (Borma and Sharma, 2011).