

Intensive Bank Analysis

A three-day case study based workshop for credit risk, fixed income, origination and regulatory professionals. An in-depth analytic approach to the credit analysis of both local and international commercial banks.

TARGET AUDIENCE

Intermediate level workshop for credit risk management, fixed income, origination and regulatory professionals. The two day Introduction to Bank Financial Statements is designed as a preparation for those with limited accounting and banking experience. The workshop Emerging Market Bank Analysis covers a similar analytic approach but with a focus on emerging market specific issues. This workshop is recommended as a preparation for our advanced level workshops: Early Warning Signals in Banks and Advanced Bank Analysis.

COURSE OBJECTIVES

The overall goal of this intensive three day workshop is to provide participants with structured approach to analysing the credit risk of banks and the skills to make an independent assessment of the strengths and weaknesses of a bank.

Participants will be equipped to:

- Use a structured approach to the analysis of banks, incorporating the CAMELS framework within the wider context of the operating environment and support
- Identify strong & weak performers using a detailed analysis of financial statements within the context of local and international accounting and business norms
- Identify financial, qualitative and market early warning signals of credit migration
- Stress test bank capital and ability to withstand credit, market and liquidity risk
- Evaluate strategy and risk management capabilities within the context of the current and future economic climate and changing competitive, political and regulatory conditions, including Basel III capital and liquidity requirements.

CONTENT

ANALYTIC OVERVIEW

The goal of this section is to establish a structured framework of analysis and use market indicators to give a first view on a credit.

- Overview of the frameworks and tools of bank analysis: operating environment, financial fundamentals, management, support
- Rating agency approaches: issuer ratings, individual / financial strength and support ratings
- CAMELS (capital, assets, management, earnings, liquidity, sensitivity to market risk)
- Market perspective on credit: equity indicators, credit default swap and bond market indicators
- Purpose and payback model: a structured approach to credit analysis
- Key issues in exposures to banks: exposure profile, seniority, safeguards, pricing
- *Case study / exercise:* understanding and applying the purpose payback model and demonstrate the typical borrowing needs and repayment capacity of a commercial bank.

OPERATING ENVIRONMENT

The goal of this section is to understand the impact of external factors on the banking systems, including the economic environment, competitive environment and regulatory and supervisory pressures.

Macro economic and systemic issues

- Impact of macro economic variables on performance
- Bank systemic risk: macro prudential indicators
- Sub-prime and other drivers of credit crunch
- Macro prudential indicators of risk; credit growth, equity and property prices and FX
- Competitive and structural issues of the banking system.

Regulation and supervision

- Changing roles of the regulator and supervisor
- Key regulations: purpose and implementation
- Liquidity: quantitative and qualitative measures, Basel III guidelines for net stable funding ratio and cash coverage
- Capital: measuring size, quality and adequacy of capital base under Basel I, II and III
- Types of capital; core (common equity) vs. hybrid
- Standardised and advanced approaches for credit, market and operational risk
- Economic capital and internal capital adequacy assessment process (ICAAP)
- *Exercises:*
 - Contrasting the interplay between sovereign and banking system risk
 - Considering the impact on bank profitability of the operating environment in various countries
 - Consider and quantify the impact on bank capital adequacy ratios of the implementation of Basel III.

FINANCIAL FUNDAMENTALS

The goal of this section is to understand how to define, measure and evaluate bank performance, distinguish strong and weak performance and appreciate the limitations of the figures.

Statement logic

- Relating business mix to financial statements
- Accounting policies and disclosure: IFRS and local GAAP; fair valuation – securities, derivatives, own debt
- *Exercise:* understanding how the business model of a financial institution will impact its financial statements.

Business risk

- Loan portfolio analysis: uncovering the risk profile of the loan portfolio; key differences between types of bank
- Loan quality: impaired loans and reserve adequacy
- Off balance sheet exposures: lending commitments, SIVs, conduits and other special purpose vehicles
- Trading risk: assessing securities and derivatives portfolios, use of value at risk (VaR) models and stress testing asset quality
- Investment risk: valuation and accounting policies, hidden reserve or black hole
- *Exercises:* Understand the way in which the capital base and profitability of a bank may be influenced by their provisioning policies



- Identify the early warning signals which may be prevalent in the trading operations of a commercial or investment bank
- *Illustration case study:* assessing business risk, incorporating loan portfolio quality, trading portfolio and other credit and market risks.

Performance risk: earnings

- Balancing the risk/return profile: strategy and risk appetite
- Income stability and diversity: earnings at risk
- Control of expenses: targets and peer comparisons
- *Illustration case study:* assessing performance of a bank, incorporating overall returns, income diversity and stability and cost control.

Financial risk - liquidity

- Funding risk: stability and variety of funding sources, contingency funding
- Liquidity of assets: identifying truly liquid assets, stable funding of illiquid assets
- Liquidity of liabilities: stability of deposit base, dependence on short-term wholesale funding, inter-bank market, key challenges of repo and CP funding
- Basel III liquidity standards
- Cash capital, stress testing and other tools to control liquidity risk
- Gap management: using the tenor and interest rate mismatch tables to highlight re-pricing and refinancing risk
- Securitisation vehicles: accounting and credit implications
- *Exercise:* demonstrate how a bank's funding structure can impact its liquidity position and interest rate exposure.

Financial risk - solvency

- Leverage ratios: benchmarks and challenges
- Capital adequacy: measuring size, quality and adequacy of capital base; regulatory capital ratios and assessing regulatory capital for non deposit takers
- Stress-testing capital for market and credit write-downs
- *Illustration case study:* assessing financial risk including solvency, funding strategy and liquidity in the light of the risk profile of the business model.

Early warning signals

- Financial and non-financial indicators of distress
- Market indicators: equity, CDS and bond indicators
- Lessons learned from failed banks
- *Exercise:* distinguishing strong and weak players.

MANAGEMENT, FRANCHISE AND OWNERSHIP

The goal of this section is to focus on the key risk areas of strategy, franchise and risk management.

- Management: strategy, systems, skills, structure
- Risk management
- Franchise - strength of banking business model
- *Exercise:* distinguishing business models and defining and understanding the key areas of risk faced by a bank and then to focus on what procedures are in place to manage the risks.

SUPPORT

The goal of this section is to identify which institutions may receive government or shareholder support and in what form that support may be received.

- Reliance on support: rating floors, which creditors are supported, loss absorbing capability of hybrid capital
- Solvency vs. liquidity problems
- Regulatory responses to banking crisis: recapitalisation, guarantees, bad banks, insurance
- *Exercise:* recognise the main approaches to support employed by governments and their pros and cons.

GROUP CASE STUDY

The goal of this closing case study is for participants to apply the analytic framework to identify the strengths and weaknesses in a developed market commercial bank.

Learning Paths

