

Emerging Market Bank Analysis

A three-day workshop offering a structured approach to the credit analysis of emerging market banks, addressing sovereign systemic and macro prudential risk, key performance indicators, early warning signals, stress tests and the impact of changing Basel II and Basel III regulations.

TARGET AUDIENCE

Credit risk management, origination, banking, fixed income and regulatory professionals focusing on emerging market banks. This workshop is targeted at an intermediate level and is the next step after the two-day Introduction to Bank Financial Statements workshop. This workshop covers the same analytic frameworks and tools as the Intensive Bank Analysis but focuses on emerging market rather than mature market banks.

COURSE OBJECTIVES

The overall goal of this workshop is to give a structured approach to the credit analysis of banks in emerging markets. The workshop will equip participants to:

- Apply a structured analytic approach incorporating the operating environment (sovereign and systemic risk), financial fundamentals, management and support.
- Identify banking systems with high systemic risk and evaluate the potential impact on the banking system.
- Evaluate the financial statements to identify strong and weak performers and recognise the key areas of vulnerability in emerging market bank financial statements.
- Use both international and local financial, qualitative and market indicators to distinguish early warning signals of credit deterioration.
- Recognise the impact of the sovereign, systemic and regulatory change on bank performance and strategy and identify the need for and likelihood of support for different types of creditors in a crisis.

CONTENT

ANALYTIC OVERVIEW

Section aims: apply a structured approach to the credit analysis of emerging market banks and compare this with the perspectives of regulators, rating agencies and debt and equity investors.

- Frameworks and tools of analysis: sovereign, operating environment, management and franchise, financial fundamentals (CAMELS) and support
- Differing approaches: banks, rating agencies, regulators, equity and bond investors
- Sovereign and bank debt ratings: issuer default, national, individual and support
- Market indicators of risk: equity, bond, CDS and deposit rates
- Exercise:* identifying relative creditworthiness, likelihood of default and failure from different types of ratings
- Purpose payback model: structured approach to analysis
- Case study:* using the 4 step model to evaluate appropriate bank exposure strategies.

OPERATING ENVIRONMENT

Section aims: anticipate systemic risk driven by either sovereign or banking system weakness and evaluate the impact of macro economic, competitive and regulatory change on bank financial health and performance.

Sovereign risk

- Key macro-economic indicators: GDP, interest, inflation and FX rates, current and capital account, savings and investment, unemployment etc.
- Key structural issues- Latin America, Eastern Europe, Asia and Africa.
- Sustainable debt levels: public and private sector, domestic and external debt and liquidity
- Exercise:* identifying strong and weak performers across different emerging market regions
- Social and political factors: political stability, labour force, legal system, trade and political links, contagion.

Banking system

- Macro prudential indicators of systemic risk: credit growth, asset price inflation etc.
- Credit crises: causes and effects
- Competitive environment: role of key players, banking penetration, product diversification
- Legal system: bankruptcy laws, recovery rates; judicial process.

Regulation and supervision

- Prudential supervision and conflicts of interest
- Key regulations: international vs. local benchmarks, implementation
- Exercise:* assessing bank regulations in different emerging markets
- Capital adequacy: Basel I vs. Basel II, implications of Basel III; liquidity and core capital.

FINANCIAL FUNDAMENTALS

Section aims: define, measure and evaluate bank performance through balance sheet, income statement and key financial ratio analysis. Appreciate the limitations of the figures given and the challenges of different accounting regimes.

Statement logic

- Banking business models and balance sheet configuration
- IFRS vs. local GAAP: key differences
- Limited disclosure: looking behind the numbers.
- Exercise:* emerging market bank balance sheet recognition indicators.

Business risk

- Loan quality: growth, concentrations, impaired loans (definitions and accounting)
- Reserve adequacy: provisioning, write-offs and recoveries, capital and profit distortions
- Off balance sheet exposures: trade finance, derivatives and other contingencies
- Trading and investment assets: liquidity pool or black hole
- Related parties: contagion and other risks
- Case study:* in-depth business risk assessment of an emerging market bank.



Performance risk

- Risk / return profile: quality and diversity of income
- Control of expenses: high inflation and IAS 29
- Earnings accrual and asset impairment
- *Exercise*: in-depth performance risk assessment of an emerging market bank.

Financial risk – liquidity

- Stability and variety of funding: stability of insured and uninsured deposit base, dependence on inter-bank, access to money and capital markets
- Liquidity: liquidity of assets and liabilities, contingency funding plans
- Basel III liquidity provisions: net stable funding ratio and liquidity coverage
- Gap management: FX, interest rate and maturity exposures
- Securitization: impact on earnings, assets and capital
- *Exercise*: identification of liquidity and FX vulnerability in various banks in an emerging market experiencing systematic collapse.

Financial risk – capital adequacy

- Capital adequacy: size, quality and adequacy, economic and free capital
- Impact of Basel II and III capital adequacy changes on banks.
- Capital distortions: under-provisioning, revaluation, deferred tax, risk weightings etc.
- *Exercise*: stress testing capital ratios after for deficient accounting systems or inappropriate risk weighting
- *Case study*: in-depth financial risk assessment of an emerging market bank focussing on funding liquidity and capital adequacy.

Early warning signals

- Financial and non-financial indicators of distress in emerging markets
- *Exercise*: emerging market banks' failure predictive ratios.

MANAGEMENT, FRANCHISE AND OWNERSHIP

Section aims: evaluate the risk of differing management and shareholder structures prevalent in emerging markets and benchmark appropriate risk management and corporate governance behaviour.

- Management - structured approach: strategy, systems, skills and structure
- Risk management – credit assessment and recovery; liquidity preservation, trading controls and operational risk.
- *Exercise*: risk assessment in banks ,implications of failure ,minimum safeguards and due diligence questions
- Franchise and competitive advantage
- Shareholder risks: contagion, corporate governance, related party, transparency, succession.

SUPPORT

Section aims: use lessons learned from banking crises to anticipate the availability of support for the creditors of a failing bank from either Government or shareholders.

- Solvency and liquidity problems: potential solutions
- Lender of last resort: safety net from shareholders and/or government
- Bank rescues: comparing supervisory and other intervention in a variety of problem situations
- *Exercise*: assessing the likelihood of support from shareholders or governments in the event of bank failure across different types of banks and emerging markets.

FINAL CASE STUDY

- Preparation and presentation of a comprehensive credit analysis of an emerging market bank, covering operating environment, business risk, performance risk, financial risks and the quality of management
- Participants will evaluate the overall risk of failure or default, assign ratings and make appropriate recommendations on exposure levels.

Learning Paths

