

Complex Derivative Transactions: A Credit Masterclass

A one-day workshop applying a structured approach to the analysis of counterparty risk in complex derivative transactions. It is designed for experienced credit analysts/approvers, auditors, and regulators and provides practice in the application of analytical tools to complex transactions.

TARGET AUDIENCE

The workshop is targeted at experienced credit analysts, counterparty analysts, and credit approvers who are comfortable with assessing plain vanilla derivative transactions but need further knowledge of how to approach complex transactions. The course is also suitable for those who design systems to record derivative credit exposures, for auditors of complex derivative transactions, and for regulators responsible for derivative transactions.

COURSE OBJECTIVES

The workshop is designed to teach participants how to assess the counterparty risk in complex derivative transactions. This will be done predominantly using a selection of real transactions which the participants will assess in small groups. The groups will make presentations on their findings and these will be discussed and assessed by all participants under the guidance of the trainer.

Specifically participants will be equipped to:

- Assess the overall purpose for entering into a complex transaction
- Draw diagrams to show the cash flows during the transaction
- Assess what movements in underlying variables create credit risk
- Estimate the amount and timing of the resultant credit risks.

BACKGROUND

Derivative markets continue to grow in size, in product range, and in complexity. While plain vanilla trades still make up the majority of outstanding trades, more complex transactions comprise an increasing proportion of new over-the-counter transactions. As a result, understanding the structure of complex trades and their risks is more important than ever for credit analysts and credit approvers, as well as those who review transactions, such as auditors, regulators, and systems professionals.

This course will aim to enable participants to develop the skills necessary to decompose, or otherwise assess, complex trades to the point where the type and magnitude of the counterparty risk in the trade can be estimated. The course is not highly quantitative: the task of modelling counterparty risk in the systems of financial institutions is beyond the scope of this course. Completion of the course should enable participants to have a good understanding of the purpose and pay-offs in complex trades as well as understanding the risks.

Understanding the theory behind complex trades is relatively straightforward. However, reviewing a term sheet for a transaction and evaluating it from beginning to end is far more challenging. Participants on this course will spend most of the time evaluating a variety of transactions, thereby building the experience and the confidence to assess any complex trade.

CONTENT

ANALYTIC FRAMEWORK

Structured approach to transaction analysis

- Purpose of transaction
- Diagram of transaction
- Cash flow of transaction
- Risk drivers
- Risk assessment and quantification

TRANSACTIONS

- Risk assessment and estimation of pre-settlement risk and other credit risks for approximately twelve different transactions
- Transactions will include:
 - Interest rate risk, including swaps, caps and floors, and swaptions
 - Foreign exchange risk
 - Equity risk, including options and total return swaps
 - Credit derivative risk
 - One or two transactions based on more exotic underlying instruments (for example, a variance swap).
- Risk assessment to involve assessing different types of credit risk:
 - Pre-settlement risk / current MTM
 - Settlement risk
 - Payment timing mismatch risk
 - Premium payment risk
 - Lending risk.