FitchTraining

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Credit Risk: Introduction to Key Concepts

A one-day introductory course offering an overview of the key tools and concepts of credit risk management in financial institutions and how they fit into Basel II capital allocation. The course is for non-credit, financial services professionals wishing to understand better how credit risk impacts the business of their employers or clients.

TARGET AUDIENCE

This is an introductory level workshop for those who are new to corporate credit. It is designed for bankers, investors, lawyers and other users of financial reports and accounts who have limited or no prior knowledge of analysis of corporate financial information. This is a prerequisite for those wishing to attend a Corporate Credit workshop but lack the financial background to do so.

COURSE OBJECTIVES

The aim of this one-day workshop is to enable participants to understand the key concepts of credit risk and how this risk is managed within financial institutions.

The aim is to equip participants with the knowledge and skills too proactively:

- Identify the different types of credit risk and how they arise in a financial institution's various activities
- Understand how credit risk can be quantified, monitored and controlled, exploring the role of credit portfolio management tools such as collateral, documentation and credit derivatives
- Understand the need for capital, differentiating between definitions of capital applied by various stakeholders such as management and regulators.

CONTENT

OVERVIEW OF CREDIT RISK

Section Aims: To enable participants to understand the importance of credit risk to a bank or financial institution, understand the different forms that credit risk can take and recognise early warning signs of high credit risk.

Key banking activities and the importance of credit risk.

- Categories of credit risk: lending, contingent, issuer, pre-settlement, settlement, country/transfer, other
- Impact of credit risk on the performance and financial standing of a financial institution
- Quantifying credit risk: default, recovery and migration statistics
- Capital adequacy: the need for adequate capital to meet unexpected losses
- Recognising the early warning signs of high credit risk.
  - Composition/growth of portfolio
  - High risk sectors
  - Non-performing loan ratios
- Loan loss reserves and adequacy.

Case study/exercise: Recognising credit risk in an international bank. Identifying problem areas of the portfolio and assessing loan loss reserve adequacy.

CREDIT ANALYSIS

- *Section Aims*: To enable participants to carry out a structure approach to credit analysis and recognise some of the issues which arise from exposures to differing customers and counterparties.
- Overview of debt ratings: understanding the types of and purpose of debts rating
- Approach and criteria applied by the rating agencies
- Structured approach to credit analysis: Purpose, Payback, Risks and Structure
- Types of counterparty: corporates, financial companies, special purpose entities, and holding companies
- Sources of payback from each type of counterparty
- Transaction risk analysis: categorising and analysing the risks.
- Components of structuring to mitigate against default.

Case study/exercise: Recognising the balance sheet of differing types of financial counterparty.

CREDIT RISK MITIGATION

Section Aims: To enable participants to recognise the role of different financial and other techniques in reducing credit risk.

- Structuring credit exposures - a four step approach (Exposure profile, Ranking, Safeguards and Pricing)
- Exposure profile: key features of the main credit products offered or traded by the bank: loans, leases, derivatives, bonds etc
- Ranking: senior, pari passu and junior positions
- The role of collateral and other forms of subordination such as structural or effective subordination
- Safeguards: Key types of mitigation found in credit documentation and the purpose and effectiveness of each
- Pricing: the need to be compensated for expected loss.
- Portfolio management and techniques to spread risk: Syndication, Sub-participation, Whole loan sales, Credit derivatives, Securitization.

Case study/exercise: Recognising appropriate mitigation techniques to use to mitigate credit risk across a variety of exposures.

CAPITAL ALLOCTION

Section Aims: To understand the different definitions of capital from the perspective of differing stakeholder and how capital is allocated specifically to credit risk.

- Recap of the purpose of capital and its importance in relation to credit risk
- Regulatory capital (Basel II): measuring regulatory capital for credit risk under standardized and advanced measurement approaches
- Changes to the Basel capital framework 2011-19, Basel "2.5" and Basel 3
- Composition of rating agency "Eligible capital" and key difference from regulatory capital
- Economic Capital: What the Economic Capital actually represents, its uses within a bank and potential issues with calculation.

Case study/exercise: Development of the capital base within a major international bank in line with industry & regulatory changes and perceptions of risk.

Learning Paths

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