

ASSESSING CREDIT RISK OF COUNTRIES AND FINANCIAL INSTITUTIONS

BANK CREDIT DEPARTMENT
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UBI  **Banca**
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Summary

- Introduction to Bank Credit Department
- Risk from Pillar I: Credit risk
- Standardised Approach
- Country analysis
- Bank analysis

Bank Credit Department – Mission -

- credit analysis of **countries**;
- credit analysis of domestic and international **financial institutions** using standardised approach;
- providing **trade finance** solution (L/Cs with postfinancing/deferred payment; bank guarantees; stand by L/Cs; ECA backed transaction; credit insurance) for all UBI Group's legal entities in order to promote international trade;
- Suggesting a price range for all **trade finance** business (confirmed L/Cs; L/Cs with postfinancing/deferred payment; bank guarantees; stand-by L/Cs; ECA backed transaction);
- issuing of foreign **guarantees**;
- relationship with ECA's (**Export Credit Agencies**) such as SACE and EBRD, IFC, etc.

LOANS

LETTERS OF CREDIT

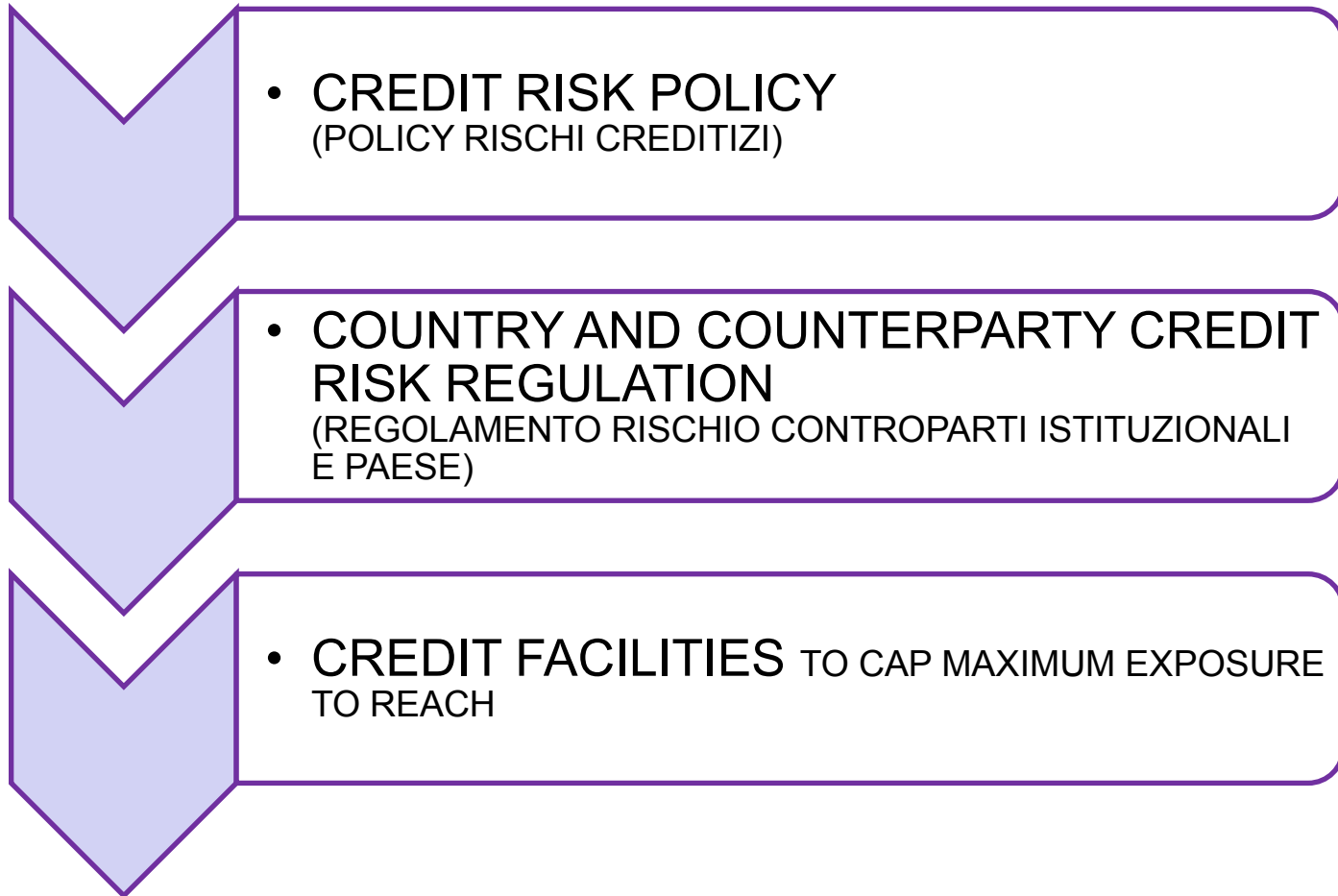
SYNDICATED LOANS

FINANCIAL GUARANTEES

DERIVATIVES TRADE

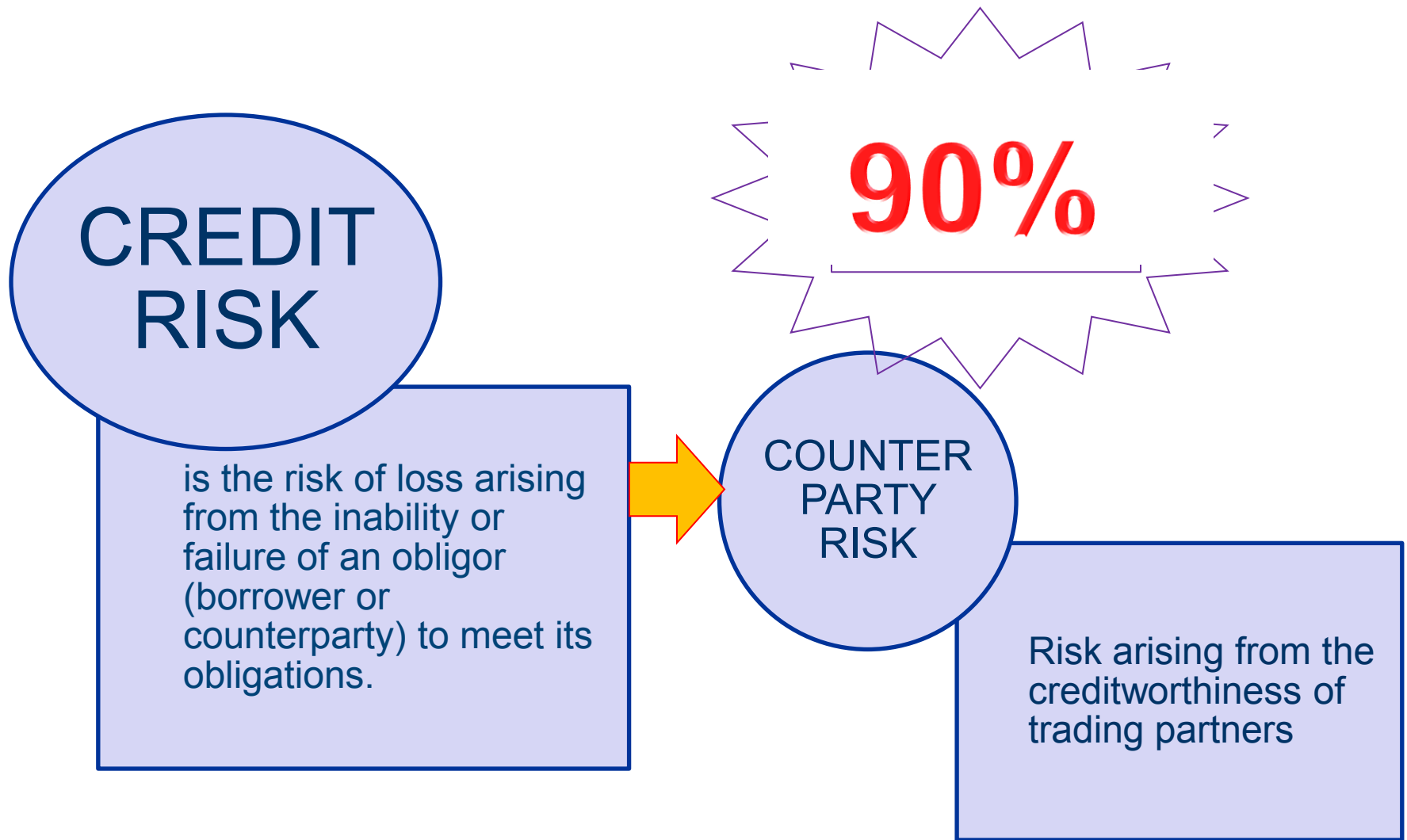
MONEY MARKET OPERATIONS

FOREX EXCHANGE



PILLAR I RISKS as follows:

- CREDIT RISK the risk of incurring **losses** resulting from the **default** of a counterparty. This also comprises counterparty risk in the definition; it is the risk that a counterparty defaults before the transaction itself is settled;
- MARKET RISK risk of **changes** in the **market value** of financial instruments held, due to unexpected changes in market conditions and/or in the credit rating of the issuer
- OPERATIONAL RISK the risk of incurring **losses** resulting from the inefficiency or procedures failure, **human error**, business disruption, **system failure** and so on



EXTERNAL CREDIT RATINGS = STANDARDISED APPROACH

There are three broad approaches to credit risk ⁽¹⁾ (Basel II) :

1. Standardised approach;
2. Bank's internal rating systems (IRB);
3. Advanced bank's internal rating systems (A-IRB)

UBI GROUP APPLIES:	BORROWER	
STANDARDISED APPROACH	SOVEREIGN	INSTITUTIONAL
BANK'S INTERNAL RATING SYSTEM		
ADVANCED INTERNAL RATING SYSTEM	CORPORATE (2012.06.16 provision n.423940)	RETAIL (2013.07.19 provision n.689988)

⁽¹⁾ (the standardized approach to credit risk, Basel Committee on banking supervision (january 2001))

External Credit Assessment Institutions

FITCH

- Long-term Issuer Default Rating
- The ability to meet financial commitments in the long-term, independently of the maturity of individual obligations. This rating is an indicator of the probability that an issuer will default.
- AAA: best rating – D: default

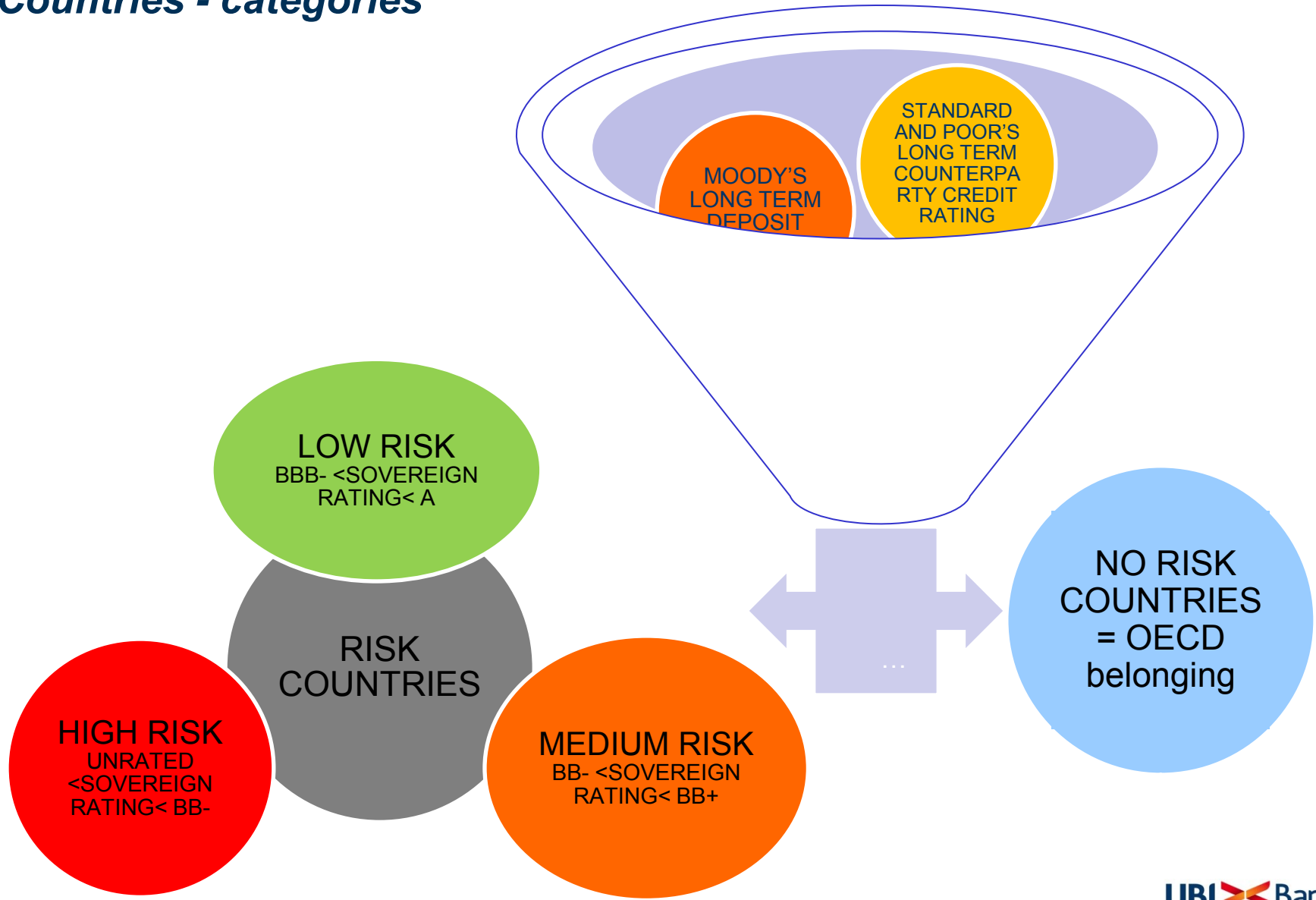
Moody's

- Long-term debt and deposit rating
- The ability to repay long-term debt (maturing in or after one year) in local currency.
- (Aaa: best rating – C: default)

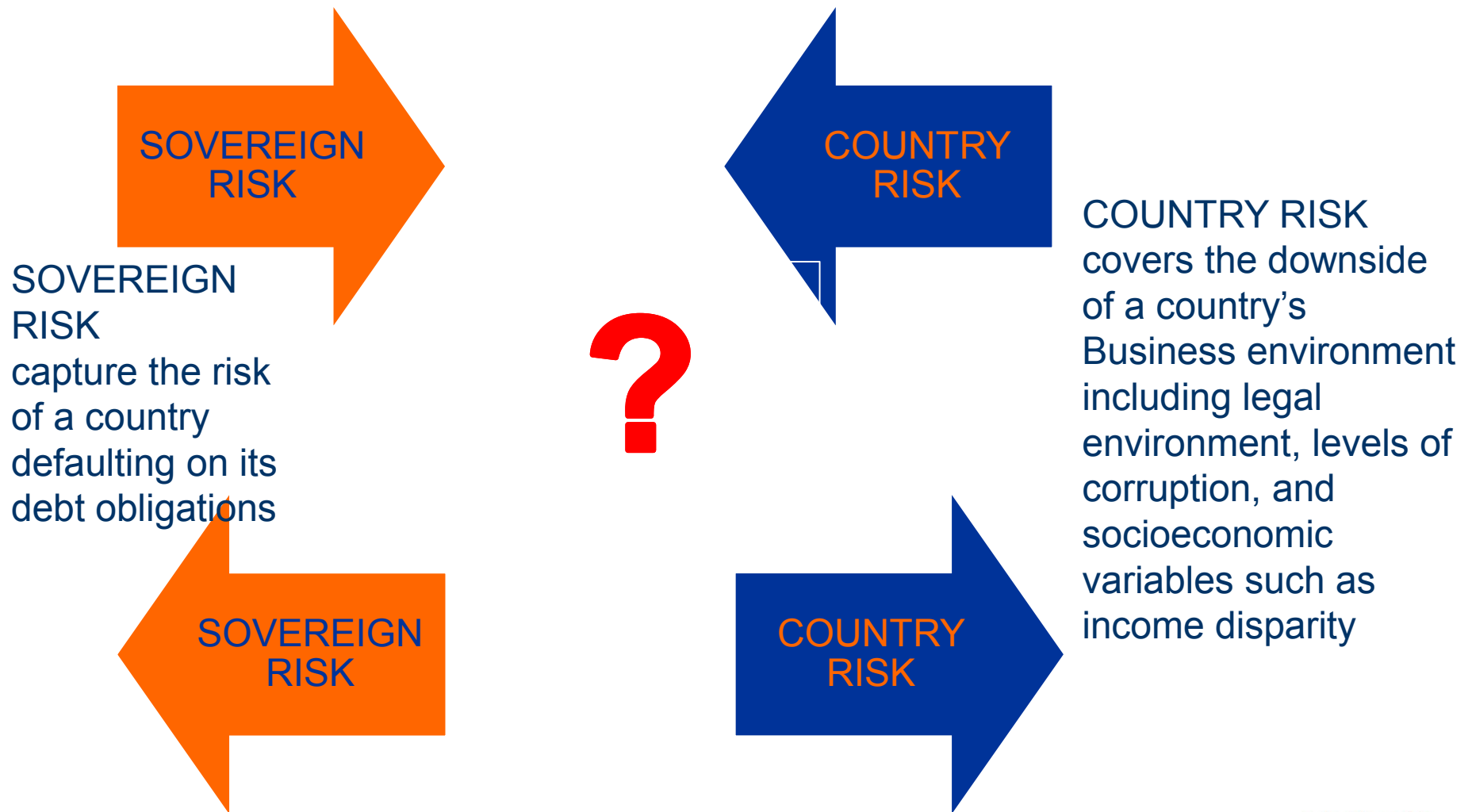
Standard and Poor's

- Long-term Counterparty Credit Rating
- The issuer credit rating reflects the agency's opinion of the intrinsic creditworthiness of the bank combined with an assessment of the potential for future support that the bank might receive in the event of default .
- (AAA: best rating – D: default)

Countries - categories



Sovereign risk - country risk



Country risk – key factors

- general legislation;
- business legal environment;
- corruption;
- political stability;
- good government;
- regulation;
- size and potential of domestic market;
- education, literacy rates and technological sophistication

Country risk – major indices widely available

- CORRUPTION PERCEPTION INDEX – CPI – cpi.transparency.org
- GLOBAL COMPETITIVENESS INDEX - GCI - www.weforum.org/reports/global-competitiveness
- DOING BUSINESS RANKINGS www.doingbusiness.org
- UNITED NATION HUMAN DEVELOPMENT INDEX - HDI - hdr.undp.org
- WORLD BANK POLITICAL RISK INDICATOR

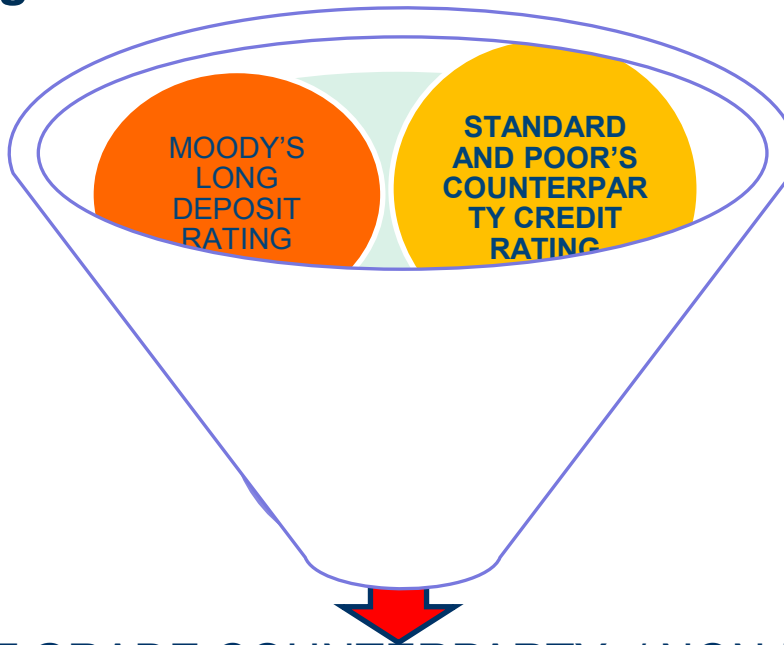
SOVEREIGN RISK

COUNTRY RISK

Country limits are set in order to constrain the risks potentially arising from country-specific or region specific event.



Counterparty risk - categories



INVESTMENT GRADE COUNTERPARTY / NON INVESTMENT GRADE COUNTERPARTY

LONG TERM FOREIGN CURRENCY ISSUER DEFAULT RATING

High Investment grade in no risk countries (AAA to A-)

Investment grade in no risk countries (BBB+ to BBB-)

Non investment grade in no risk countries (BBB- to unrated)

Investment grade in risk countries (BBB to BBB-)

Non Investment grade in risk countries (BBB+ to BBB-)

Non Investment grade in risk countries (BB+ to B-)

Case by case assessment

BANKS AND BANKING GROUPS –

Institution licensed as a receiver of deposits and a lender of loans

SECURITIES FIRMS AND GROUPS HEADED BY A SECURITIES FIRM

ASSET MANAGEMENT COMPANIES AND SICAVS

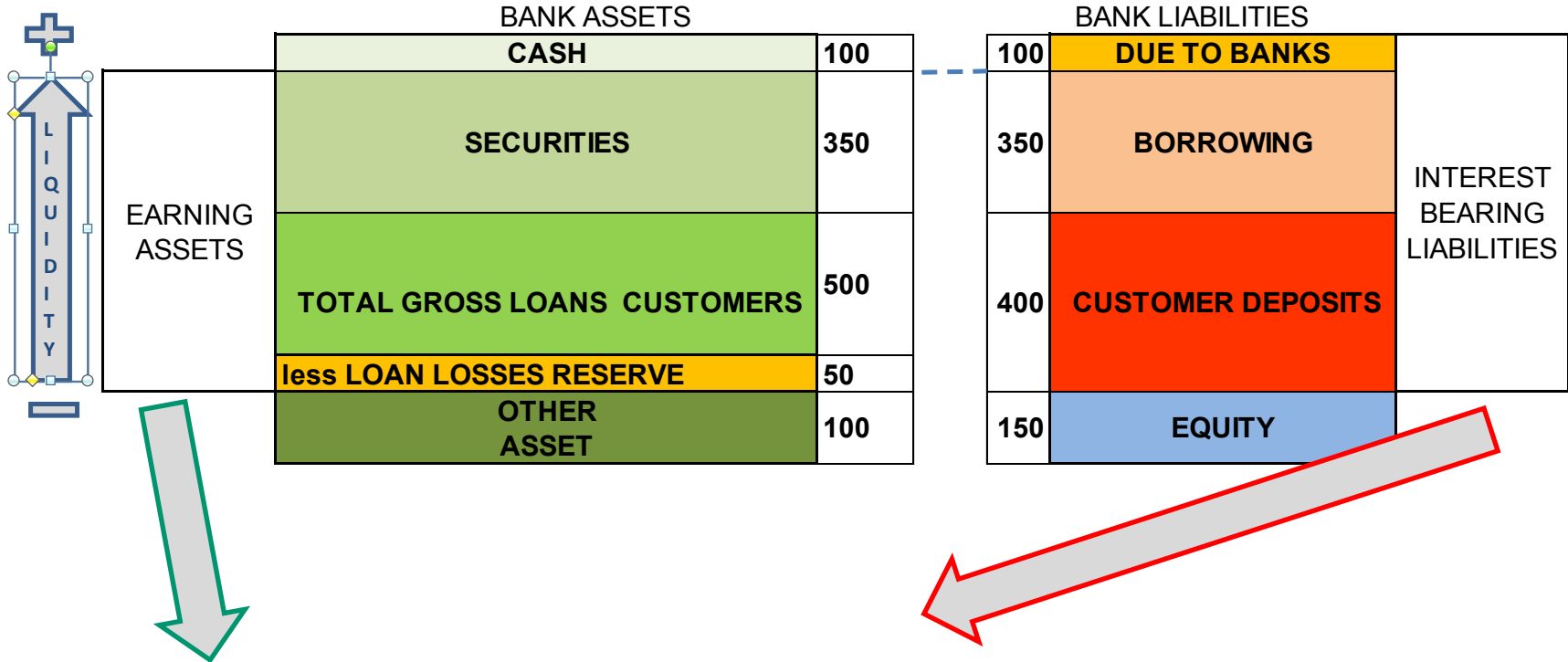
FINANCIAL INTERMEDIARIES REFERRED TO IN ARTICLE 107 OF THE CONSOLIDATED LAW ON BANKING

ELECTRONIC MONEY INSTITUTIONS - EMIS

PAYMENT INSTITUTIONS

FINANCIAL CONGLOMERATES

Counterparty risk – bank balance sheet – income statement



INTEREST GAIN – INTEREST PAID = NET INCOME INTEREST
Main component of REVENUES

Counterparty risk – ratios analyses

TIER 1 RATIO

- First part of the two-tier risk based capital standard commonly used by regulatory agencies to assess a financial institution's capital adequacy.
- **TIER 1 CAPITAL / TOTAL RISK-WEIGHTED ASSETS**

NET INTEREST MARGIN

- Indicates how well management employed the earning asset base
- **Net Interest Income (annualized) / Average Interest Earning Assets**

NPL ratio

- a loan is non performing when payment of interest and principal are PAST DUE by 90 days or more
- **NON PERFORMING LOANS / TOTAL LOANS**

NET INTEREST INCOME TO REVENUES

- it gives you the revenues split, how much revenues comes from the net interest income and how much derived from fees and trading gain

NPL coverage ratio

- A decrease basically means banks were provisioning less for their bad debt.
- **IMPAIRMENT ON LOANS / OUTSTANDING OR GROSS NON-PERFORMING LOANS**

COST/INCOME RATIO

- Efficiency improves as the ratio decreases **TOTAL NON-INTEREST EXPENSES / TOTAL NET INCOME**

LOAN/DEPOSIT RATIO

- Indicates the percentage of a bank's loans funded through deposits
- Maximum 80% to 90% (the higher the ratio the more the institution is relying on borrowed funds)
- **LOANS (GROSS) / TOTAL DEPOSITS**

COST OF RISK

- it measures the proportion of a bank's total loans that have been lost due to NPL
- **NET CHANGES IN IMPAIRMENT FOR CREDIT RISKS / AVERAGE OUTSTANDING LOAN PORTFOLIO**



CIAO!