



BankT&D Consulting

Credit Ratings for Bankers

Credit Analysis, Pricing and Return on Capital

“Bridge the gap between credit analysis, capital requirements, pricing and returns.”

Course description

This intensive credit course seeks to enhance both credit analysis and pricing skills by providing an in-depth look into the methodologies of major rating agencies. (Moody’s, Standard & Poor’s).

The course covers, step by step, the mechanics of several rating methodologies across various industries. The choice of key factors and metrics, and how these are weighted in scoring systems to arrive at a rating, is explained in detail. This process is then compared with the conventional corporate credit application templates used by large banks.

The course also reviews the calculation of capital requirements under Basel II-III-IV and explains the close relationship between the ratings of rating agencies, probability of default (PD) and internal bank ratings. It then shows how rating methodologies, once understood, can be applied to unrated corporates exposures to determine their capital requirements and appropriate pricing.

This is a practical course, which is based on real life case studies discussed first in groups and then in class.

Course Objectives and Benefits

Ratings are used by a wide variety of investors, banks and regulators, including the Basel Accords, and as such their workings are mandatory knowledge for analysts and credit professionals.

The primary objective of the course is to enhance the analytical skills of the delegates by giving them hands-on exposure to the technical aspects of the rating process: choice of key factors, choice and relevance of quantitative metrics, calculation of the score and conversion into a rating.

Beyond that however, the course also aims at bridging the gap between the credit analysis process and the calculation of capital requirements, pricing and returns, by applying rating methodologies to unrated corporate exposures.



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This implies a review of capital requirements calculations under the various Basel Accords, including an introduction to the Basel IV revisions and fundamental concepts, such as Expected and Unexpected losses and economic capital.

Audience

Understanding the workings and implications of credit ratings is essential knowledge for analysts, lenders, investors and fund managers.

This version of the course however is more specifically intended for bankers, analysts focussing on banks and regulators as it focussed on capital requirements.

Non-banking professionals will find most of the course relevant, but they may prefer to attend the version of the course dedicated exclusively to rating agencies methodologies.

The metrics (E.g. ratios) used by rating agencies are analysed in depth but no accounting knowledge is assumed.

Day 1

I. Credit risk, Capital Requirements, Returns and Pricing

How margins and fees convert into ROE-RORAC/RAROC returns.

- Capital adequacy requirements - The regulatory frameworks.
- Risk weighted assets.
- ROE calculations- RORAC/RAROC pricing.
- “Hurdle rates.”

II. The Basel II-III Accords- a fast-track approach

- Internal ratings and External ratings.
- Economic capital.
- Expected and Unexpected losses.
- Probability of default, Loss Given Default and Exposure at Default.
- The Risk Weight Function (RWF).
- Capital Adequacy Requirements –The 3 Approaches.
- Introduction to Basel IV.

III. External Ratings

- What do they measure?
- Ratings scales-Moody’s, S&P, Fitch.
- Global vs. local scales.
- Sovereign and Cross-border risk.
- Ratings and probability of default (PD).



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- Mapping internal ratings to external ratings

IV. Credit applications vs. Rating Methodologies

A. What they have in common

A similar approach: identification of industry fundamentals to guide the analysis

Exercise: the retail industry

B. Where they differ

1. **Different focus:** investment grade bonds vs. loans
2. **Different financial metrics-Rationale**
3. **Credit Application vs. Scoring system**

- Scoring system: the quantification of credit risk.
- Conversion of key factors into ratings-Calculation and mechanics.
- Ratings and Probability of Default (PD).

Day 2

V. Case studies applying the acquired knowledge.

Case studies are based on real-life companies, the use of industry analysis modules and the credit rating methodologies for the industries concerned. Cases are first discussed in groups, then presented and discussed in class.

In each case, delegates are required to:

1. Identify the industry's fundamentals and critical success factors.
2. Assign their own rating, as though they were a rating agency, and motivate their choice.
3. The rating agency's methodology for the industry in which the company operates is then reviewed and explained by the presenter.
4. Delegates must then use the rating agency's methodology to work out, step by step, a rating for the company.
5. The PD associated with the rating and the Basel II Risk Weight Formula are used to calculate the RORAC return/correct pricing of the transaction.

Case Study 1- Retailer

- Read the company's latest annual report.
- The retail industry's fundamentals and critical success factors have already been covered.
- Assign a rating to the company.



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- Apply the rating agency's methodology for the retail industry to the company to work out a rating.
- Calculate the capital required and RORAC return for the proposed loan and pricing.
- Presentation to class and discussion.

Case Study 2 – Chemical Company

- Same steps as case study 1

Case Study 3 – Pharmaceutical Company

- Same steps as case study 1

Day 3

Case Study 4 – Mining company

- Same steps as case study 1

Case Study 5 – Steel company

- Same steps as case study 1

Case Study 6 – Oil company

- Same steps as case study 1



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The Instructor

Jean-Charles spent seven years in the Credit, Corporate and Investment Banking divisions of Citibank, including three years in the World Corporation Group in London as Vice-President, managing a portfolio of UK multinationals on a worldwide basis.

He subsequently worked as Director of Project Finance and Acquisition Financing for Security Pacific in Frankfurt before returning to South Africa in 1993 as Head of Corporate Banking (Senior Vice-President) for the local operation of ABN-Amro.

Jean-Charles has broad credit experience gained over 20 years as credit analyst, credit officer and credit committee member at Citibank and ABN-Amro, covering Corporate Investment Banking, including, inter alia, Syndications, Project Finance, Leveraged Transactions and Asset Securitisation.

He was also in charge of ABN-Amro's Financial Institutions Unit for the whole of Africa for a number of years and acquired extensive specialist credit and transactional experience in that field.

He has provided in-house training to international banks such as Citibank, Deutsche Bank, ING, Nordea, CIBC, Investec and many others.

He is Director, Credit and Basel IV Services, at BankT&D Consulting Limited, a London-based consulting firm.

He holds an LLB and an LLM in Tax Law from the University of Liège in Belgium.