Credit Risk Programme

Module 1

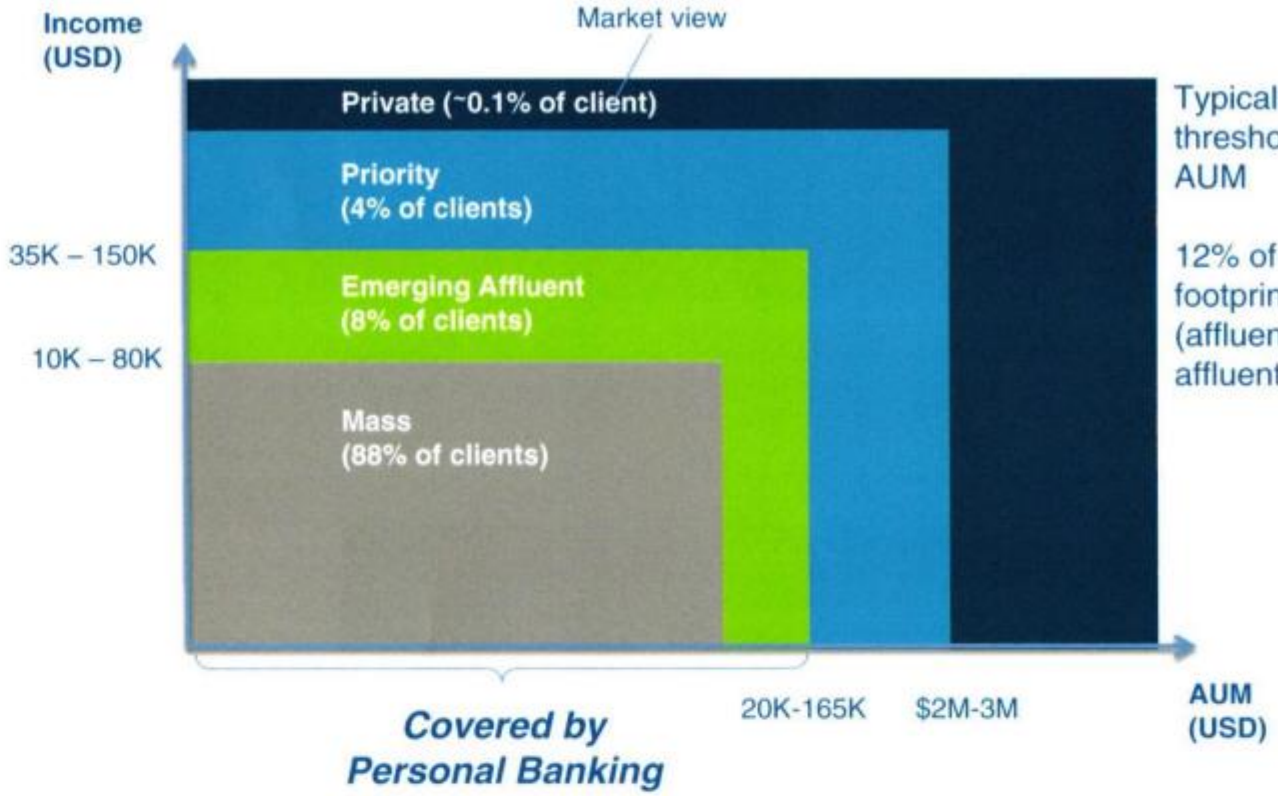
The Retail Product

Learning Objectives

At the end of this session, you will be able to:

- Describe the Retail Banking (RB) product cycle from a customer's perspective
- Define the RB Credit Cycle of a facility
- Understand the design elements of Retail Banking Products
- Identify product design elements as they relate to risk mitigation

Segments in Retail banking



Typically defined with thresholds in income and AUM

12% of clients in our footprint are Priority (affluent) or emerging affluent

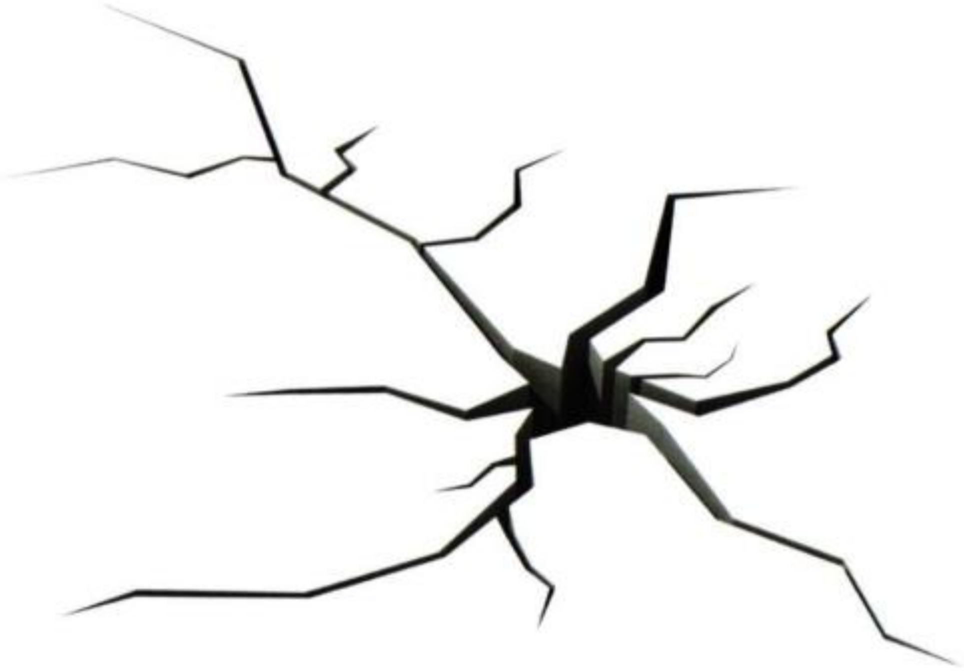
What Characteristics Describe these Target Populations?

	Customer Life Cycle			
	Young	Middle	Mature	Retired
Age				
Income				
Employment				
Financial Behaviour				
Credit Need				
What Else?				

What Product Should be Offered to Each Group?

	Customer Life Cycle			
	Young	Middle	Mature	Retired
Credit Card				
Mortgage				
Personal Loan				
Overdraft				
Line of Credit				
Instalment				
Other Innovations?				

Common Risks for Consumer Lending Businesses



- Credit/Direct lending risk
- Documentation risk
- Operations/Process risk
- System risk
- Fraud risk
- Collateral risk
- Interest rate risk
- Price risk
- Legal/Regulatory risk
- Political (sovereign) risk
- Disaster/Event risk

Credit Cycle

Product Strategy	Underwriting	Account Management	Collections & Recovery

• Customer needs
• Target market
• Market Consideration
• Structuring a credit product
• Terms & conditions
• Type of risk
	• Identification of borrower
	• Identification of security
	• Determination of LTV
	• Targeting
	• Segmentation
	• Distribution sources
	• Tools
	• Risk assessment
		• Line management
		• Credit concerns
		• Line increase
		• Line decrease
			• Balancing act among
			    • Customer
			    • Credit expense
			    • LI
			• Tools
			• Strategies

Consumer Lending Characteristics

- Large customer base
- Large volume, small loans
- Utilize indirect business sourcing
- Products tied to consumer life cycle needs
- Limited financial data on consumers which can be supplemented with credit bureau data on their borrowing history
- Process dependent, volume approval process
- Portfolio management by aggregate performance statistics

Product Planning

At the end of this session, you will be able to:

- Product, target market, credit policies
- Credit initiation processes
- Loan impairment expectations
- Level of returns – RORWA, LI%ANR, LAR%ANR

No amount of Risk Management can protect you from a poor product design

Retail Lending Products: Key Elements

Credit Card	• Maximum Unsecured Exposure (MUE) cap at 12-24x, depending on customer segments • Debt Service Ratio (DSR) cap at 60-70% • Portfolio management actions include line increase, balance transfer, authorizations • Line increase not more 1x in the last 6 months • Payment holiday 1x in the last 12 months
Mortgage	• Loan to Value (LTV) ranges from 70% - 90% • DSR cap at 65% - 70% • Amortizing loan structure (excluding “interest only” during construction up to for 3 years)
Personal Loans	• MUE cap at 12x – 24x • DBR cap at 60% - 70% • Maximum tenor of typically 60 months • No negative amortization

Business Banking Products: Key Elements

Risk Approach	Program Lending	• Standardized credit acceptance criteria for relatively homogenous target customer segments • Aim to cover 80% of risky by rules & parameters, rest by controlled used of judgements (L3) • Volume business model for standardized & simple products with smaller Limit and Net At Risk • Portfolio management for standalone term relationships (ex. BIL, GIL, Mortgage) • Rule driven client account monitoring for relationship managed customers with BWC facilities • Collections / delinquency management and rule based provisioning standard
Products	BWC	• Suite of simple working capital and trade products, and FX towards for hedging • Mandate minimum credit turnover through SCB accounts • Tenor in line with purpose (in general < 6 months, except overdraft and BG) • Requires tangible collateral: gov't guarantees, credit insurance or product recovery as second way out
	BIL / GIL	• Small unsecured / partly secured term loans with maximum 3-5 years tenor for BIL, 5 years tenor for GIL • Target customer segment: SB and micro SB with annual turnover < $10M • Decisions largely based on minimum acceptance criteria, credit bureau behaviour, scorecards, proxy repayment capability calculations (DSR), supplemented by risk based credit interview and visit. • Non-Financial income proof used – i.e., bank statement official business tax statement/VAT records • Aggregate on-us and off-us unsecured exposure to mitigate over borrowing risk
	Mortgage / LAP	• Long tenor property secured loans • Repayment by monthly instalment • List of acceptable property types (commercial, industrial and residential) along with associated Collateral Recovery Rates (CRR) documented in Country Credit Approval Document (CAD)

Wealth Management Products: Key Elements

Class 1	• Lending against diversified liquid collateral from investment grade issuers. LTVs determined by: 1. Equities - historical volatility, mkt. cap and trading volume (liquidity). 5000+ stocks with LTVS from 30-70% 2. Bonds - LTVS on sovereign and corporate investment grade bonds. LTVS based on tenor and issue size (minimum USD250m) 3. Structured products - LTVs for all 100% principal protected (PP) and select non-PP structures. List of issuers restricted to 10 global names 4. Mutual funds - LTVs on funds reviewed and distributed by SCB. LTVs based on volatility 5. Others - insurance, hedge ,funds etc. LTVs applied on individual product basis	
Class 2	• Lending against non-diversified, non-standard collateral which may have limited liquidity - e.g., promoter share financing. LTVS determined on bespoke basis based on review of the client, existing corporate relationship with WB etc.	
Class 3	• Lending against residential and commercial real estate. includes amortizing and interest-only mortgages	
Class 4	• Margin trading platform for sophisticated Private Bank customers offering trading across various asset classes - FX, equities, fixed income	
Class 5	• Provider Risk - e.g. GVEC / Maddoff • Product Risks - We have a duty of care lo ensure a) Counterparty pricing is lair b) Pricing clients fairly - no gouging, especially for products with a degree ol opacity c) Adequate liquidity should client require early termination	• Suitability & Appropriateness - risks associated with a) inaccurate product risk ratings b) Client investment profiling errors c) Mis-selling / vulnerable customers

CORESTRAT

Wealth Management Products: Key Elements

	Cash	Fixed Income	Equity	Alternate
Direct	**FX Deposits Loans**	**Bonds Perpetual**	**Cash Equity**	**Commodities e.g. Gold, Real estate**
Funds	**Money Market Fund**	**F. I. Funds**	**Equity Funds**	**Real estate Funds P.E. Fund**
Derivatives	**PCI Accumulators**	**CLNs Limited Liability Notes**	**Equity Linked Notes, DRACs**	**Commodity Linked Notes**

Fiduciary & Insurance

Credit

Risks by product

Risks	Products		
	Mortgage	Auto	Cards / Unsecured
Debt servicing ability	✓	✓	✓
Funding	✓	✓	✓
Property cycles	✓		
Type of collateral	✓	✓	
Appraisal risk	✓	✓	
Documentation risk	✓	✓	
Enforcement of title	✓		
Conveyancing	✓		
Insurance company	✓	✓	✓
Increasing exposure/evergreen			✓
Lack of quality credit bureau information			✓
Disappearance of collateral		✓	
Market risk	✓	✓	✓
Concentration risk	✓	✓	✓
Fraud	✓	✓	✓

Retail Profit Model – Operating Expenses

Issue	First Year	Ongoing
Product Set-up (Systems Development, Legal)	×	
Acquisition (Marketing)	×	
Initiation (Processing, Booking)	×	
Overhead	×	×
Maintenance (Operations, Billing, Customer Service)		×
Account Closure		×
Collections		×
Fraud	×	×

Manage Product "Drivers" to Reach Profit Objective

	Revolving	Installment
$ CPA (Cost Per Account Acquired)	×	×
% Approval	×	×
% Booked	×	×
% Activation	×	-
% Line Utilization	×	-
% Revolver Rate	×	-
% Retention	×	×
% Collection Cost	×	×
% LI to ANR	×	×
% RoRWA	×	×
% LAR to ANR	×	×

Products Summary

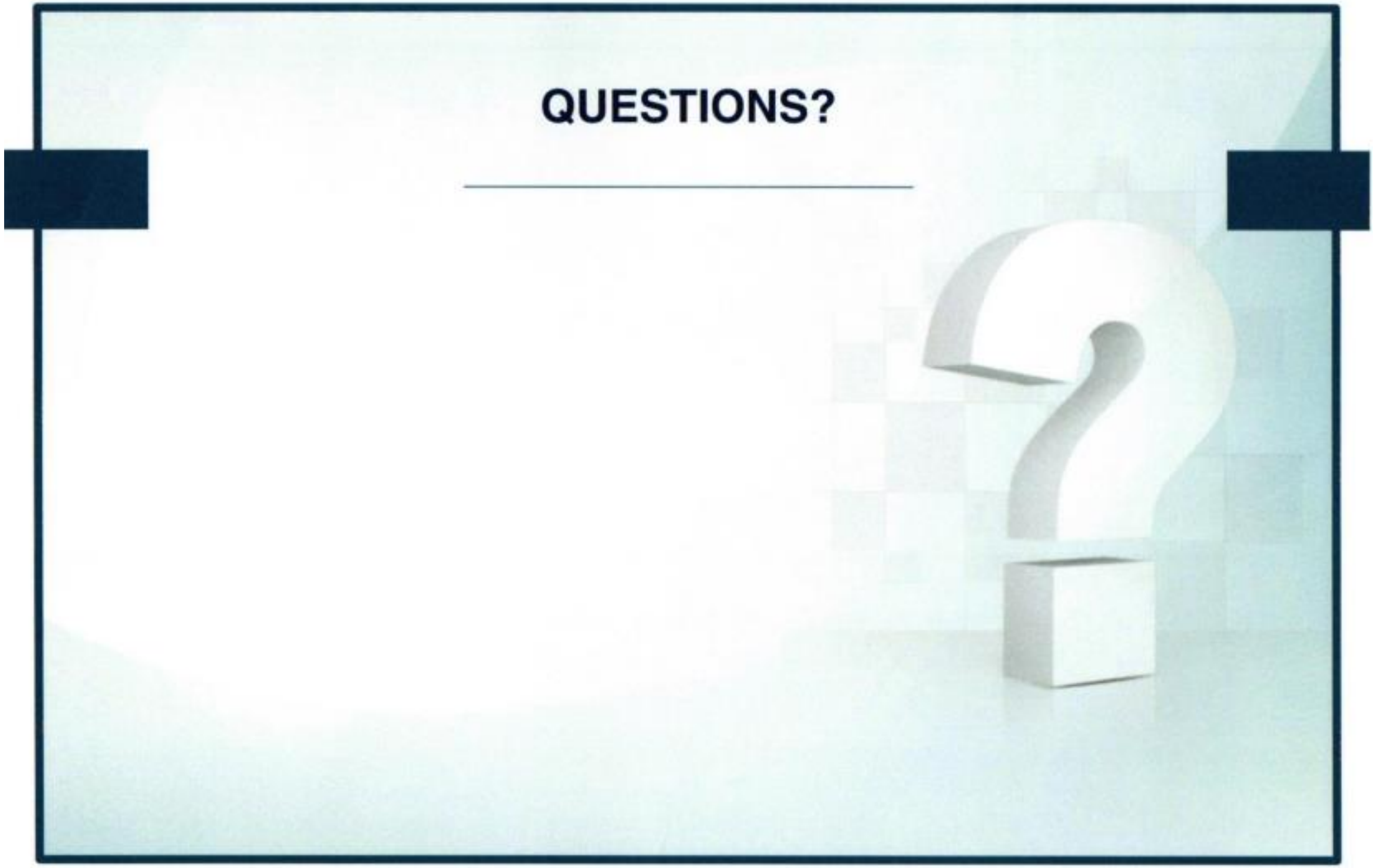
- Each product's characteristics determine the type of risks associated with it.
- These risks occur at a different stage of the product cycle.
- While these risks cannot be avoided, credit policies and processes should be designed and implemented to mitigate these risks

Points to Remember

Let's revisit some of the most important points of this section

- Good product design is a risk mitigation tool.
- Product structure and features drive profitability.
- Some costs are up-front, such as initiation, while others are portfolio running costs.
- Some costs, such as strong underwriting systems drive long term profitability.

Questions



Notes