

The logo for VfC CMS, consisting of the letters 'VfC CMS' in a bold, white, sans-serif font on a red background.

VfC CMS

Verein für Credit Management Schweiz



RECENT CHALLENGES IN CREDIT RISK MANAGEMENT

Michael Leyh

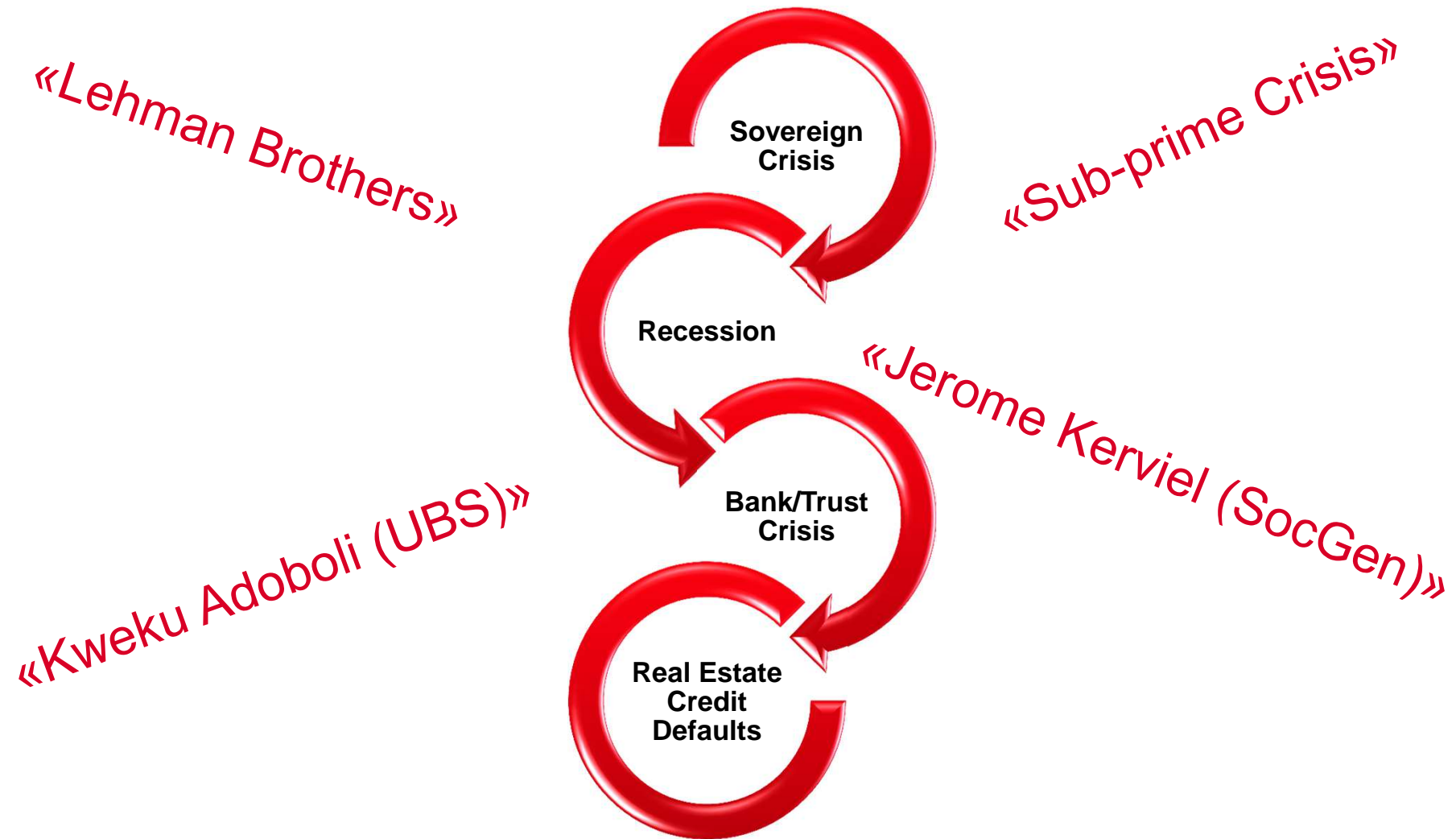
26th March 2015

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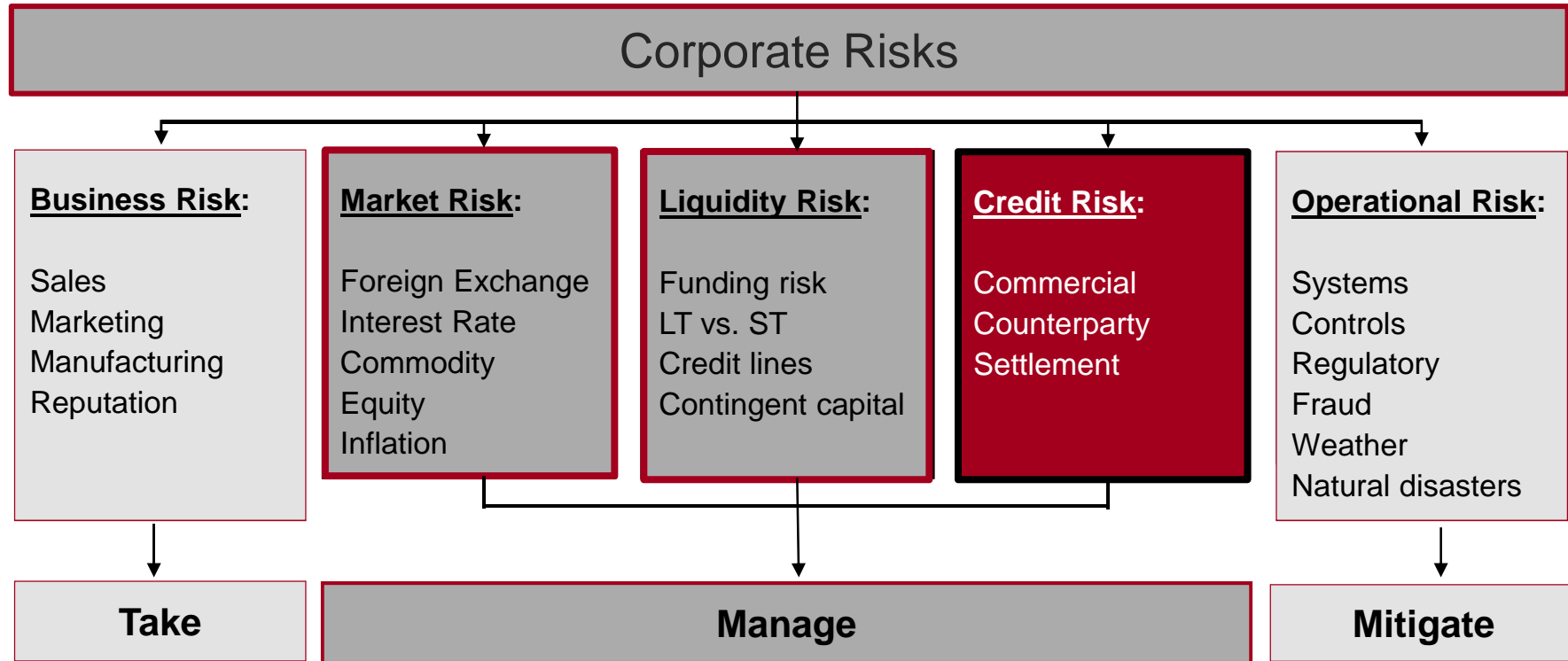
1. Changes in the Risk Landscape since 2008/09

Latest disturbances to market stability



Keeping in mind the overall risk landscape...

Source: Greenwich Treasury Advisors LLC



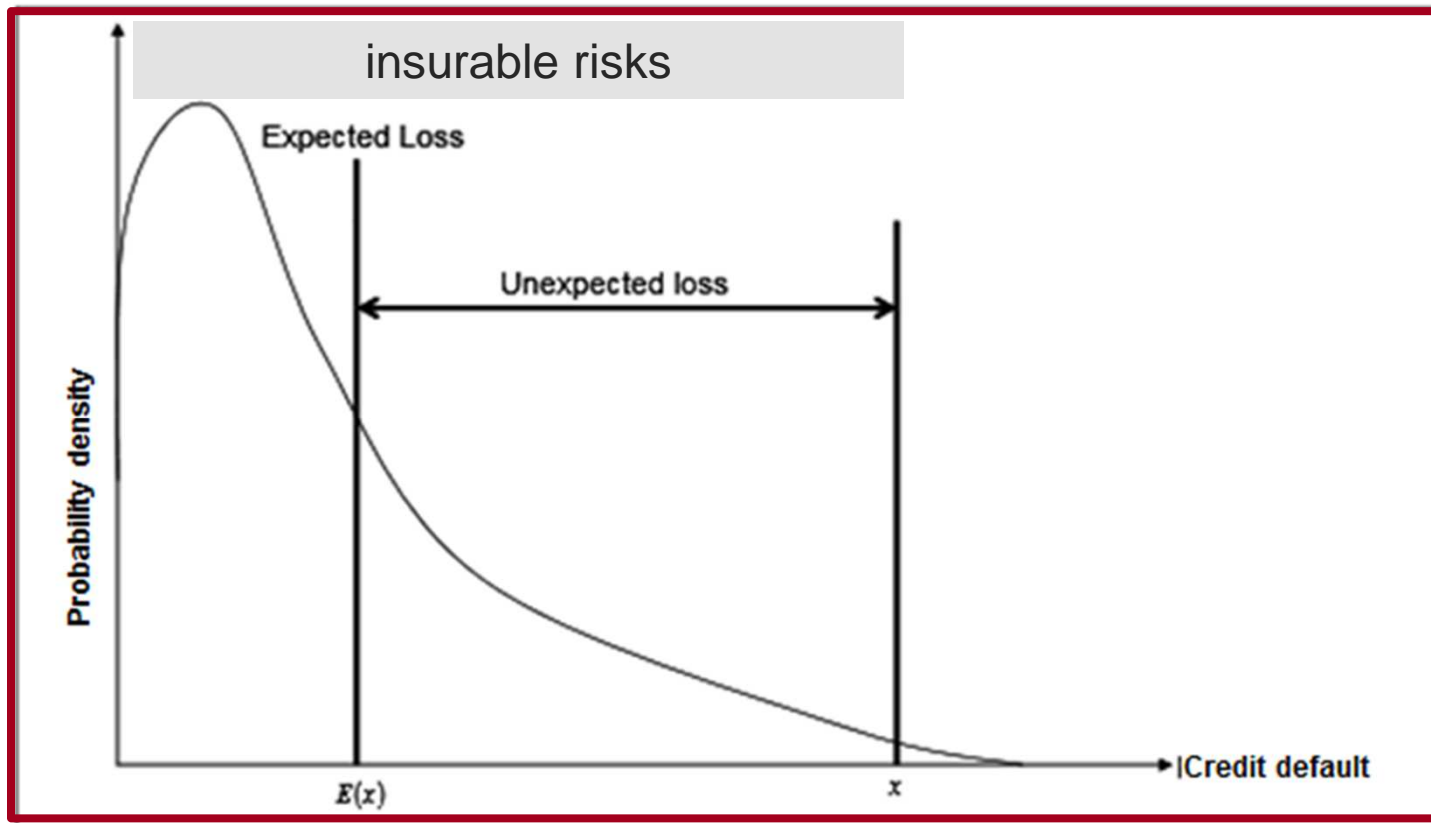
... and the risks involved in the world of credit

Source: McKinsey (2010)

Some Counterparty Risks		
Default Risk	Replacement Risk	Settlement Risk
Risk that counterparty defaults and transaction <u>fails to pay</u> ; double-default (or wrong-way) risk occurs when collateral is also impaired	After a default, risk that replacing deal <u>under same conditions</u> with another counterpart is <u>not possible</u>	Risk that the party involved in settlement, such as a correspondent bank, <u>fails before transaction</u> has completely settled

2. The importance of Credit Insurance

Knowing when to insure credit: Visualizing risk



The expected loss covers the biggest probability density

Credit insurance in the world of trading

Source: Atradius, 2013

Outsourcing some parts of credit risk activities & providing a «Safety Net»

Protection

Default, political risks,
breach of contract
(e.g. unwillingness to pay)

Financing

Buying receivables
(factoring)

Collection

Debt collection, if required

Information

News about counterparties, markets and regions

However, also some disadvantages need to be considered!

Trading without Credit Insurance? You better think twice!

Source: Own Source, Wikipedia, AIG 2013

	Physical Trading	Derivative Trading
Major Players	<ul style="list-style-type: none"> ▪ Atradius ▪ Coface ▪ Euler Hermes 	<ul style="list-style-type: none"> • Risks from Derivate Activities are NOT insurable!
Market Practice	<ul style="list-style-type: none"> ▪ Credit insurance for trading ▪ L/C ▪ Parent company guarantee 	<ul style="list-style-type: none"> ▪ ISDA/CSA Credit Management ▪ Clearing
Alternatives	<ul style="list-style-type: none"> ▪ Pre-payment ▪ Factoring 	<ul style="list-style-type: none"> ▪ Exchange trading <ul style="list-style-type: none"> ▪ if according derivative market is liquid enough
Advantages	<ul style="list-style-type: none"> ▪ Parts of Credit Risk Management “outsourced” ▪ Financial compensation in case of default ▪ To expand sales to new and existing customers 	<ul style="list-style-type: none"> ▪ Bilateral, flexible, tailor made OTC transactions ▪ «Credit Management» via margining ▪ Clearing allows to eliminate «counterparty risk»
Dis-advantages	<ul style="list-style-type: none"> ▪ Only physical trades insurable ▪ No limit that covers the entire trade <ul style="list-style-type: none"> ▪ no trade ▪ Line cancellation - higher risks 	<ul style="list-style-type: none"> ▪ Sophisticated IT-Infrastructure <ul style="list-style-type: none"> ▪ necessary to evaluate transactions on a counterpart's portfolio

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3. The importance of «Credit Management Education Programs»

A credit manager's responsibility: The cruciality of expertise, so ...

Be aware that even «well known» counterparties do default!
Therefore ...

... Measure Risks

Constantly **monitor changes** in counterparty behaviour

... Manage Limits

Set and monitor limits for each counterparty "**just in time**" to avoid losses in case of imminent default

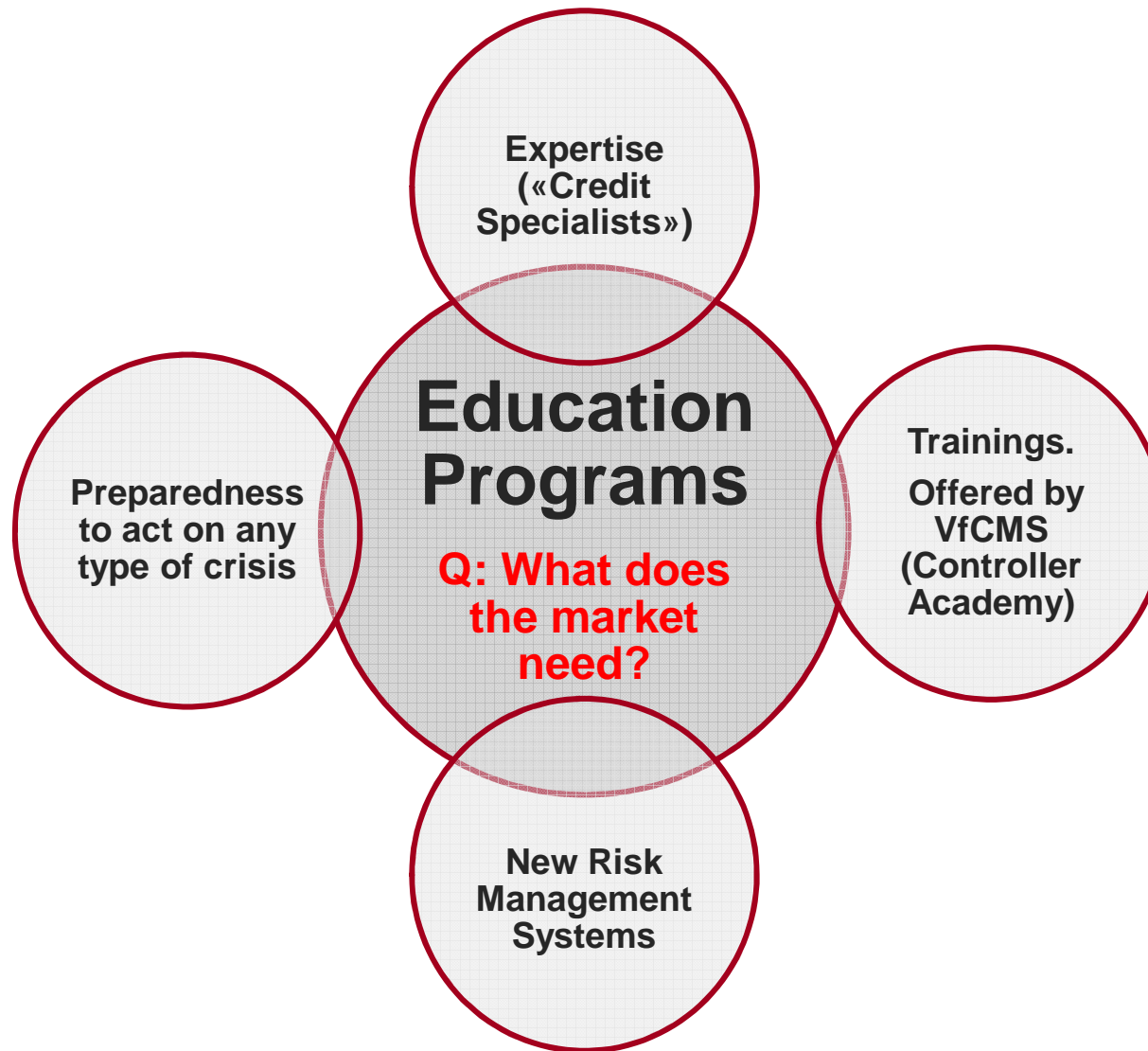
... Manage Collateral/
Bank Securities

Systematically reduce counterparties` risk exposures via e.g. collateral, L/C, pre-payment

... Manage Insurance

Transfer risks to an underwriter

Managing credit risk without specialists? You better think twice!



A changing market environment: What changes in the role of credit risk managers? ...

«Classical» Credit Management

- Bad communication / little interaction with the company
- Especially the economic situation as a center of assessment
- Hardly any use of external data
- Management of applications of payment



**Credit Manager as an «Accountant»
of the company**

«Modern» Credit Management

- Central function of the company
- Advisory function for other departments (especially distribution and of top-management)
- Use of external sources of information
 - Branching of important information



**Credit Manager as an «Advisor» to
the management**

... Exactly for such programs VfCMS is «Pioneer» in Switzerland!



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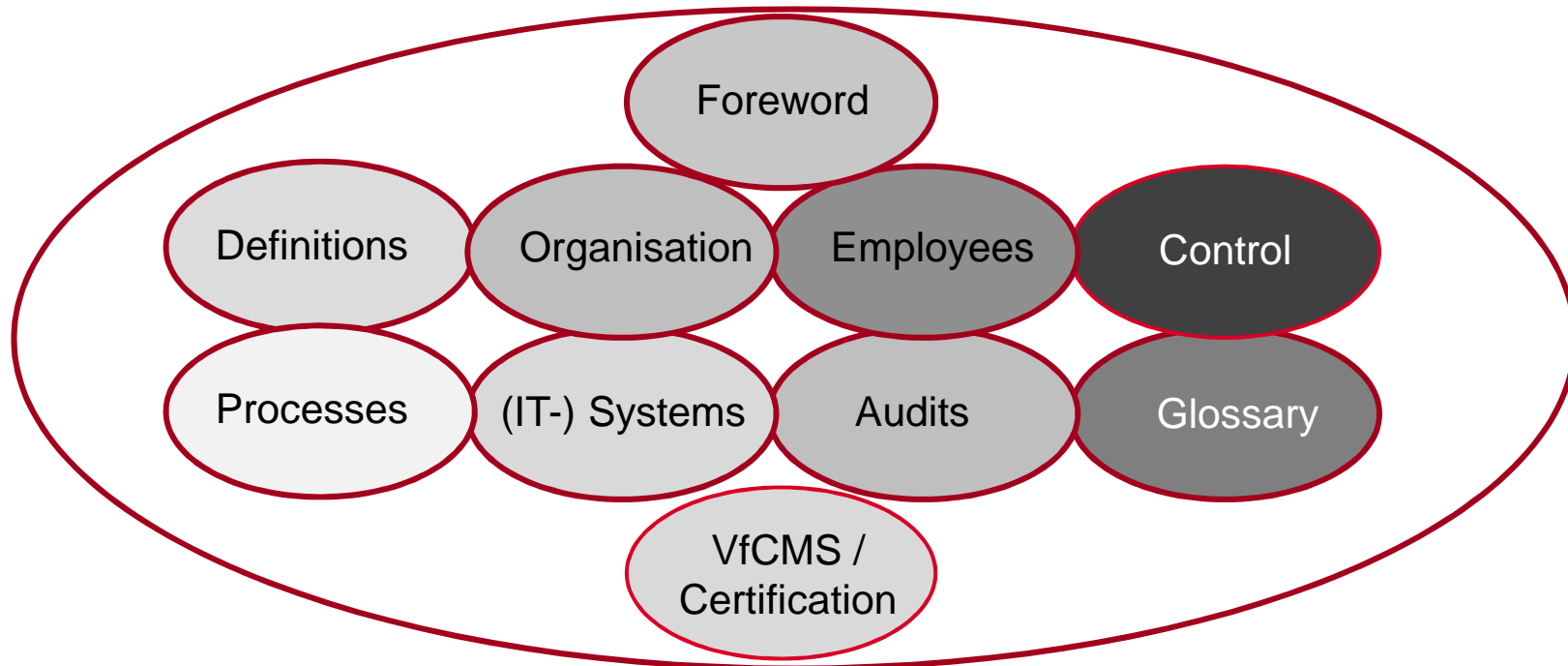
4. VfCMS's Minimum Standards for Credit Management (MRCM)

Milestones:

- 1. 1st edition was published in 2011**
- 2. 2nd edition will be published in 2015**
- 3. «Booklet MRCCM» is also an essential part of VfCMS education program**

Purpose:

«MRCM inspire users to enhance their currently implemented Credit Management System»



Summary

Key take-aways

Since the market environment has become way more complex in the past years ...

... Better think twice when:

Selling without credit insurance

Managing your credit risk without «credit specialists»

Your credit policy is not reviewed regularly

Many thanks for your attention!

And now let's start with Q & A

Food for thought: Questions for discussion

- Have you enough qualified personnel in the field of credit management?
- Are your colleagues properly educated to comply with the recent challenges in risk management?
- Are you prepared to invest in education programs?
- Do your underwriters meet your expectations?
- Do you believe you are all too dependent on your (credit) insurance?
- ...