IACPM

INTERNATIONAL ASSOCIATION OF
CREDIT PORTFOLIO MANAGERS

Business Models for Portfolio Management

Derek Saunders
Global Head of PM, HSBC

IACPM Forum
14 June 2011
Beijing

www.iacpm.org

Agenda

- What is Credit Portfolio Management?
- Why do Credit Portfolio Management?
- Key Components - The Value Chain
- Business Models / Positioning
- Developing a PM Platform – checklist
- Model Overview

What is Credit Portfolio Management?

Key Aspects of PM:

- Understanding and pro-actively managing risk & returns
- Making transparent the cost of Credit/Capital
- Recognising that there can be a finite risk appetite for ‘core’ clients
- Agreeing parameters against which the risk profile is managed
- Viewing risk as dynamic – it typically changes
- Assessing the adequacy of returns for a given level of risk
- Creating capital velocity - moves away from ‘one way’ asset flow
- Measuring risk/return on the whole portfolio as well as on individual positions

Why do Credit Portfolio Management?

Increasing expectations for the way banks manage credit portfolio risk coming from:

- Investors
- Regulators
- Markets

Typical drivers that trigger commencement of PM

- Risk concerns
- Capital constraint
- Return enhancement
- Portfolio composition
- Other

CPM can take different forms but all strive to achieve similar deliverables….

Why do Credit Portfolio Management?

Classic Deliverables:

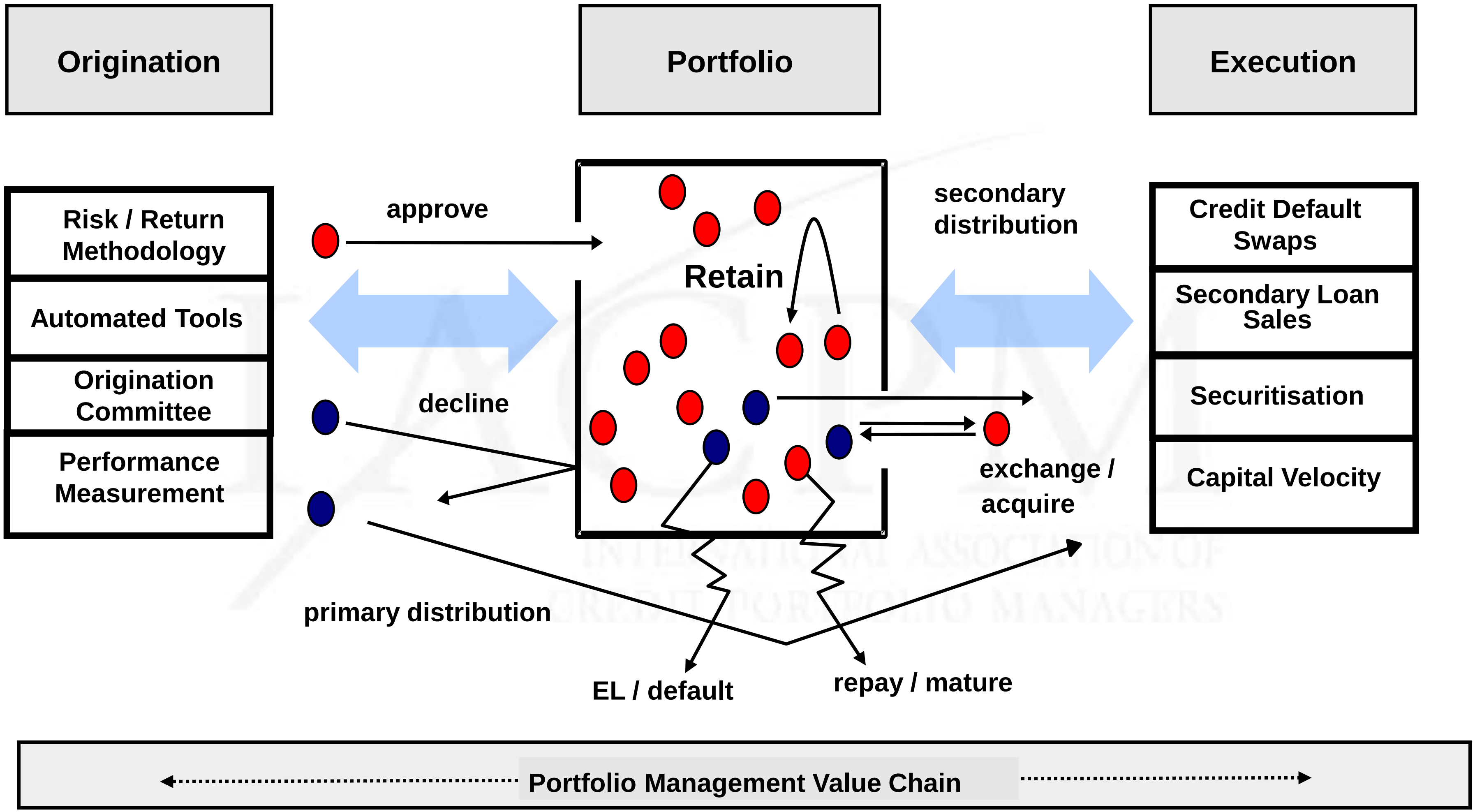
- Active management of risk and risk diversification
- Improved revenue and returns
- Improved risk pricing assessment
- Better measure of client value added
- Tools / transparency that aids origination

informed decision making

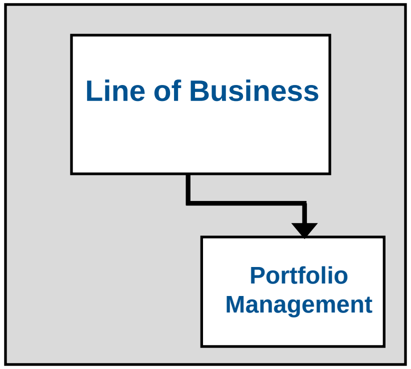
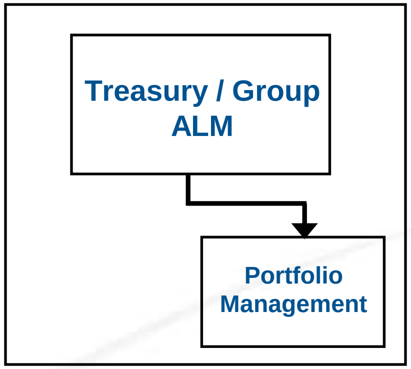
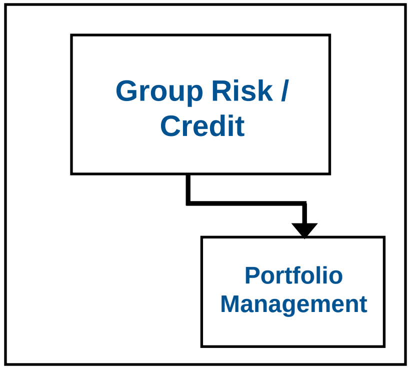
- Management of capital consumption (and velocity)
- Aligning performance measures – clarity, responsibility, accountability
- Leverage Basel data, infrastructure and use tests
- Better positioned to engage with regulators

Breaking down and understanding the components of the PM value chain…

Portfolio Management – Key Components



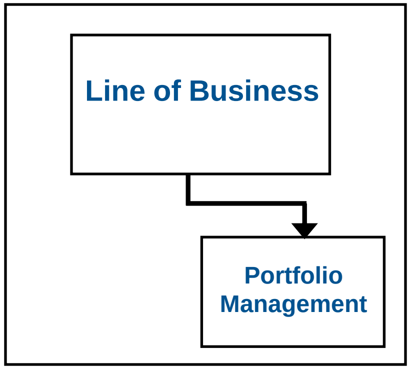
Organisational Positioning

	1)	2)	3)
Potential Positioning:			
Advantages:	• **Proactive** - helps to drive business • **Material link to origination** - business 'ally' • **Quicker to implement** - budget availability • **Performance measures** - can be aligned	• **Funding is a cost** - increasing in importance • **Access all financial risks** - (e.g. FX, rates) • **Greater ability** - to take long offensive positions • **Can be combined / hybrid**	• **Integrated** - group risk perspective • **Risk** - becomes key driver • **Ensures** - right data is used • **Can be hybrid approach**
Disadvantages:	• **Less perspective on** - bank-wide portfolio issues • **May lack organisation view** - of risk & funding position	• **Distance from the businesses** • **Difficult to drive origination**	• **Limited incentive to** optimise & grow; risk focussed • **Compliance issues** • **Likely to be cost centre / budget** • **Distance from the market**

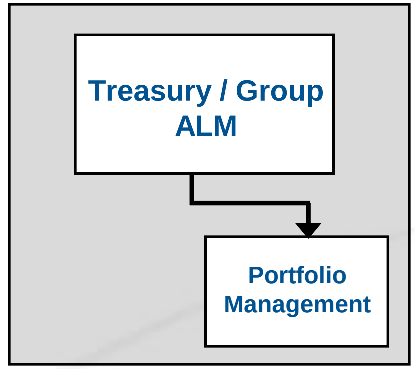
Organisational Positioning

Potential Positioning:

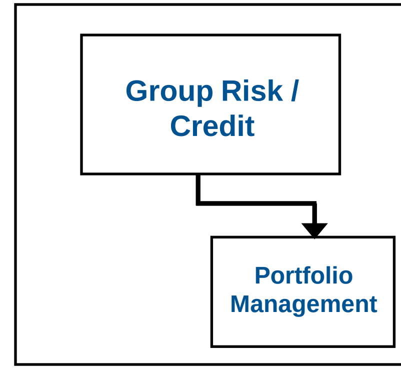
1)



2)



3)



Advantages:

1)
- **Proactive**
  - helps to drive business
- **Material link to origination**
  - business 'ally'
- **Quicker to implement**
  - budget availability
- **Performance measures**
  - can be aligned

2)
- **Funding is a cost**
  - increasing in importance
- **Access all financial risks**
  - (e.g. FX, rates)
- **Greater ability**
  - to take long offensive positions
- **Can be combined / hybrid**

3)
- **Integrated**
  - group risk perspective
- **Risk**
  - becomes key driver
- **Ensures**
  - right data is used
- **Can be hybrid approach**

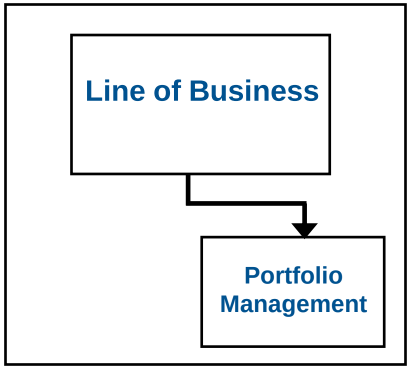
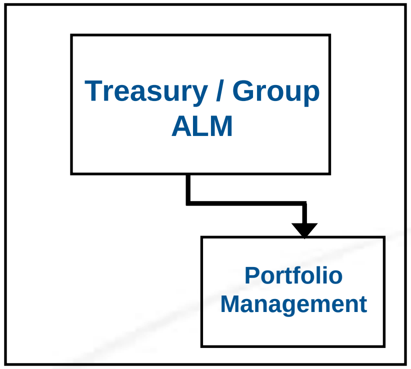
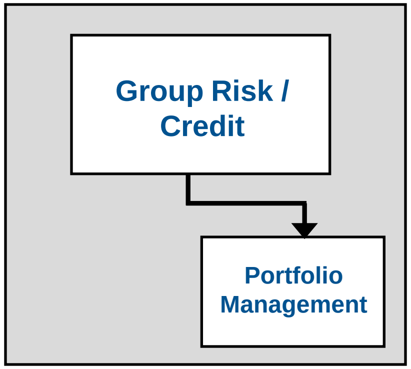
Disadvantages:

1)
- **Less perspective on**
  - bank-wide portfolio issues
- **May lack organisation view**
  - of risk & funding position

2)
- **Distance from the businesses**
- **Difficult to drive origination**

3)
- **Limited incentive to**
  optimise & grow; risk focussed
- **Compliance issues**
- **Likely to be cost centre / budget**
- **Distance from the market**

Organisational Positioning

	1)	2)	3)
Potential Positioning:			
Advantages:	• **Proactive** - helps to drive business • **Material link to origination** - business 'ally' • **Quicker to implement** - budget availability • **Performance measures** - can be aligned	• **Funding is a cost** - increasing in importance • **Access all financial risks** - (e.g. FX, rates) • **Greater ability** - to take long offensive positions • **Can be combined / hybrid**	• **Integrated** - group risk perspective • **Risk** - becomes key driver • **Ensures** - right data is used • **Can be hybrid approach**
Disadvantages:	• **Less perspective on** - bank-wide portfolio issues • **May lack organisation view** - of risk & funding position	• **Distance from the businesses** • **Difficult to drive origination**	• **Limited incentive to** optimise & grow; risk focussed • **Compliance issues** • **Likely to be cost centre / budget** • **Distance from the market**

Business Models for CPM

	Portfolio Monitor	Risk Management / Capital Reduction	Credit Treasury	Asset Manager
Objectives of PM	Portfolio Reporting	Portfolio reduction (sell / hedge) to improve risk / return	Active Management (buy / sell/ hedge) to optimise risk / return)	Asset management as stand-alone, usually fiduciary business
Alignment between PM and Origination	None	Distinct Functions	Mostly independent of origination	Total independent of origination
Credit Decision	Origination	Origination	Origination, but PM usually has input	PM
Asset Transfer / Transfer Price	N/A	Has mandate over assets but not usually Transfer Priced	Accepts risk at Transfer Price	N/A as directly booked with PM
Risk Ownership	Origination	Usually Origination	PM*	PM
Profit Centre	Origination	Origination; PM has "shadow P&L"	Both Origination and PM	PM

Examples	Traditional Full Service Banks	Full Services Banks with Investment Bank Activities	Advanced Banks with Investment Bank activities or pure Investment Banks	Fixed Income / Hedge Funds

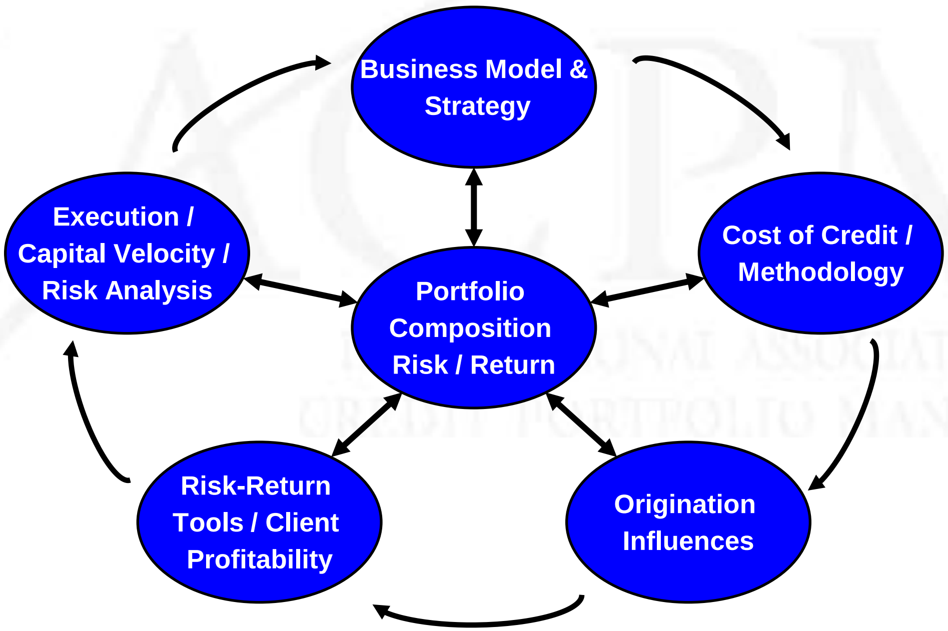
Value added →

* Number of hybrid options available

Have left out mechanics of TP or most important in making visible the cost of credit (80% Value)

Key Considerations for a CPM Model choice

1. The Firm's Business Model & Strategy - key
2. Cost of Credit Methodology – choice
3. Whether origination focus & positioning is required
4. Risk-Return Tools / Performance Measurement requirements
5. Balance of Execution / Capital Velocity / Portfolio Optimisation



Developing a PM Platform - checklist

- Align with objectives and triggers for PM
- Consider scope / geography
- Agree sponsorship / governance process
- Secure budget & resource with relevant experience
- Agree time line & core phases
- Assess data availability and complexity – Key!
- Align ex-ante AND ex-post methodology
- Communicate with Stakeholders – ongoing / repeat
- Talk with industry peers
- Consider compliance requirements
- Consider the external environment – economic / regulatory
- Pilot core aspects - back test / confirm assumptions
- Use 80/20 rule

Refer to the IACPM Sound Practices in Credit Portfolio Management

HSBC Model

- Sits in business reporting through GB
- Returns / Revenue driven strategy
- Aligns with underlying business model and strategy
- Spans the whole value chain – full active PM
- Direct execution with street
- Strong focus on origination value add
- Use underlying EC as cost of credit calc
- Covers origination, portfolio composition, execution
- 45 Headcount across 7 locations

Conclusion: PM Business Models

- Many aspects to consider
- No ideal PM model – or one size fits all
- A question of assembling pieces of the jigsaw tailored to needs / drivers
- Clear that Regulators are becoming increasingly interested in the positive impact and discipline of PM
- It can unlock significant value
- PM is becoming increasingly important

Business Models for Portfolio Management

Derek Saunders
Global Head of PM, HSBC

IACPM Forum
14 June 2011
Beijing

www.iacpm.org