Moscow Metals Summit, June 2004

No Risk, No Fun!?

The brave new world of the credit practice.

The impact of Basel II and other developments on the banks' credit p

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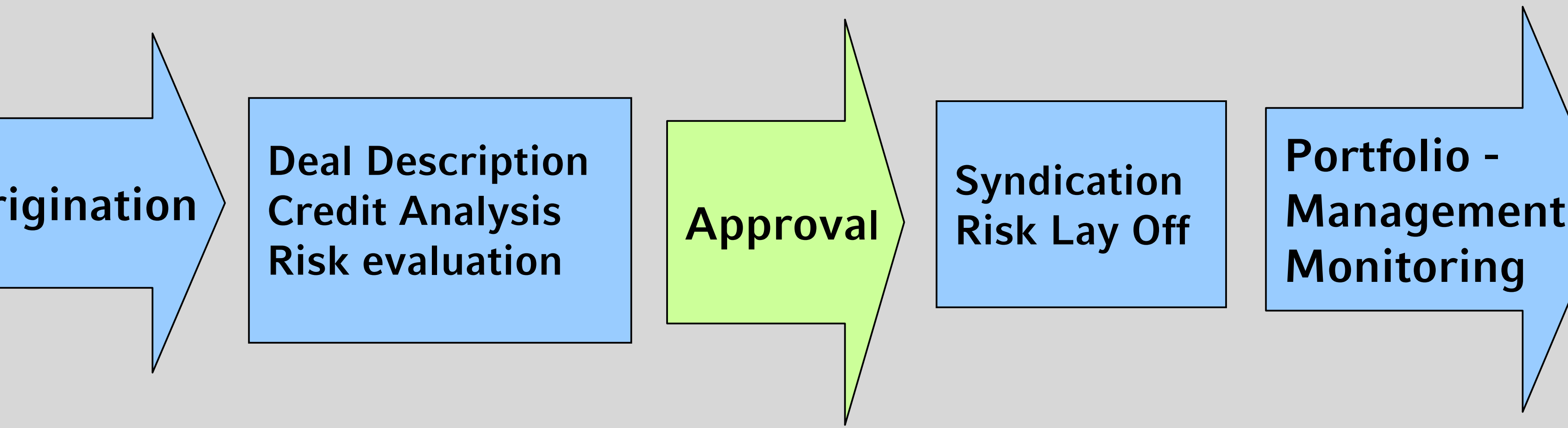
- The Credit Process
- The Basle II Accord
- Other Developments
  - Corporate Governance Aspects
  - Environmental Consciousness
- Consequences for the Client Relationship

he Credit Process

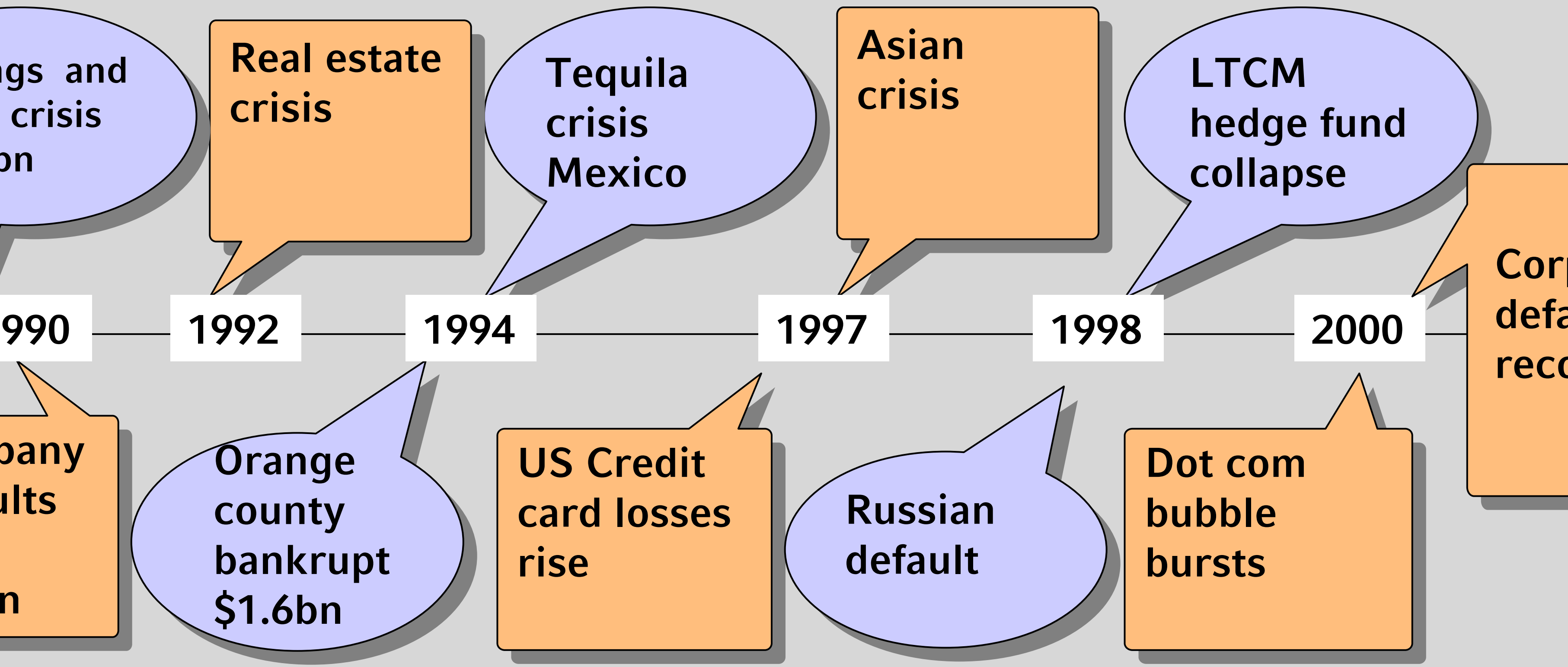
edit process had been simple and unregulated......



out a decade of credit losses triggered wave of change in credit risk managen

he Credit Process

Decade of Losses



he Credit Process

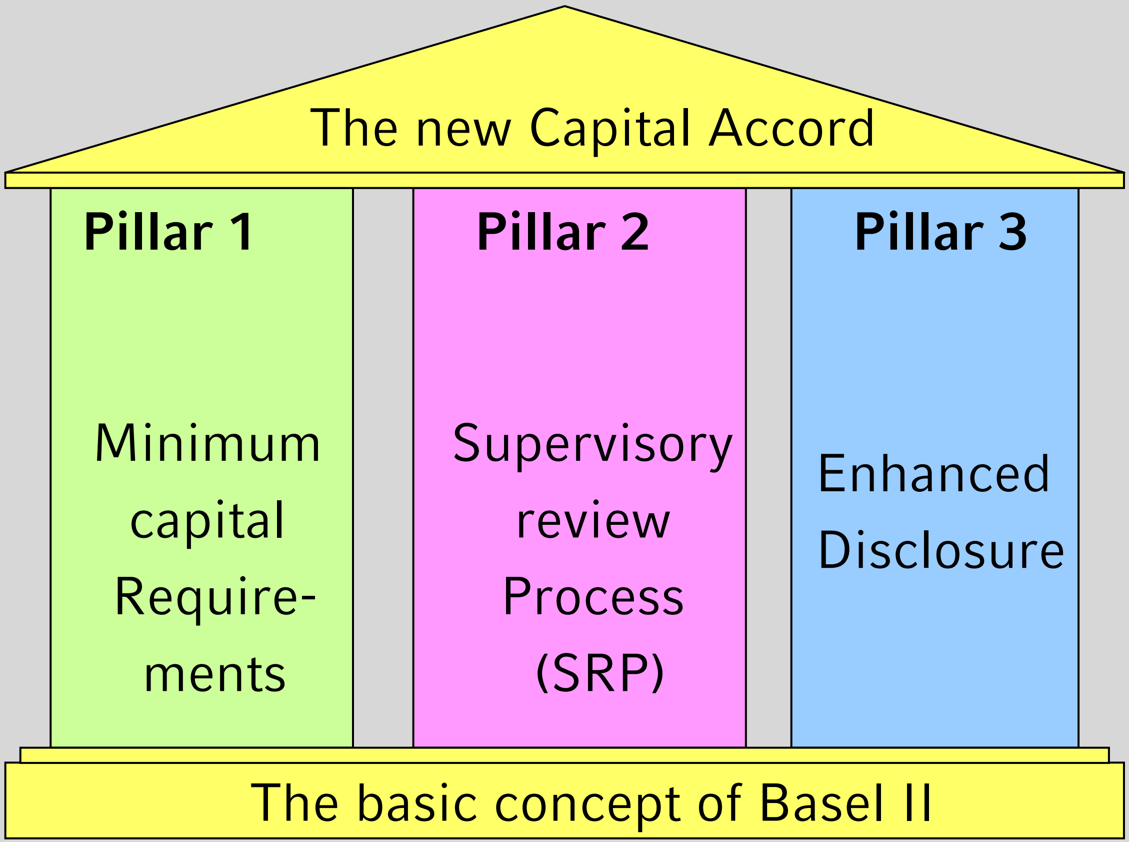
- Basel committee Sept 2002:
  ‘Principles for the management of credit risk‘
  - Risk concentration
  - Weakness in credit process

Main reasons for credit defaults

- Measures to increase solidity of banking sector
  - Basel II Accord
  - Minimum requirements for credit process of banks (MAK) (Germany only, implementation June 2004)

he Basel II Accord

Differentiation of capital adequacy
supplementation of existing quantitative standard with supervisory and market discipline (Pillars 2 and 3)



he Basel II Accord

Pillar 1 (formulaic capital charge):

- Minimum regulatory capital charge for credit risk, market risk and operational risk
- New Accord offers different approaches
  - Standardised approach
  - Internal ratings-based approach (IRB)

Pillar 2 (supervisory review):

- Supervisors need to approve a bank's use of advanced approaches and ensure that the capital position reflects its overall risk profile

Pillar 3 (market discipline):

- Expanded public disclosures by banks to facilitate market discipline

...he Basel II Accord

- Treatment of Specialized Lending

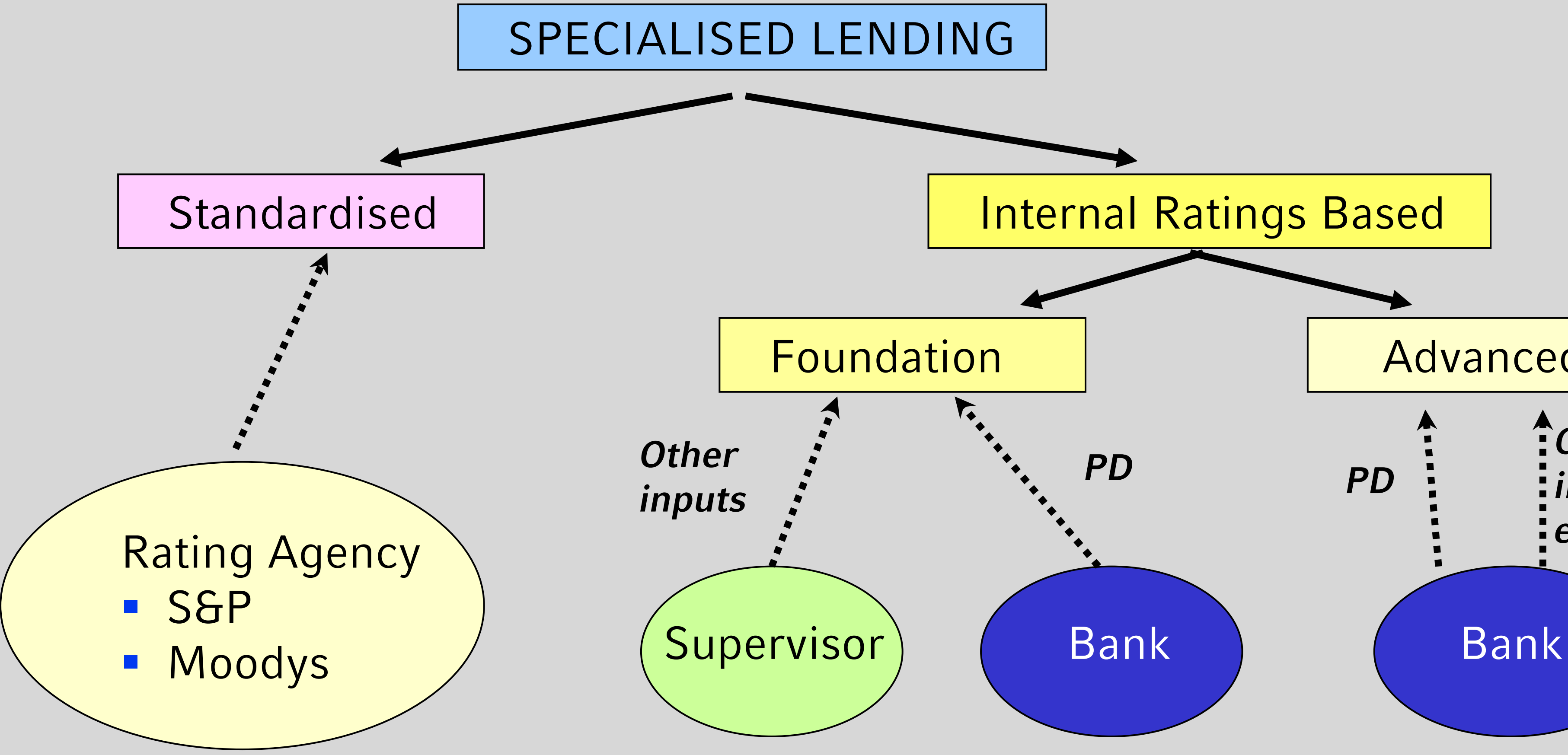
  - Primary source of repayment is income generated by specific asset(s) being financed, rather than the financial capacity of a commercial enterprise with other revenue sources

  - Four exposure types:

    - Project Finance
    - Object Finance
    - Commodity Finance
    - Commercial Real Estate

he Basel II Accord

Minimum Capital – 3 approaches



he Basel II Accord

- Map internal risk ratings into one of 5 rating grades:

Strong	AAA to BBB-	75%
Good	BB+ or BB	100%
Satisfactory	BB- or B+	150%
Weak	B to C-	350%
Defaulted		625%

- Risk weights set by Supervisory
- Slotting criteria takes into account market conditions, financial ratios, cash flow predictability, and strength sponsor

he Basel II Accord - what it will add

Sophistication

Precision, Accuracy

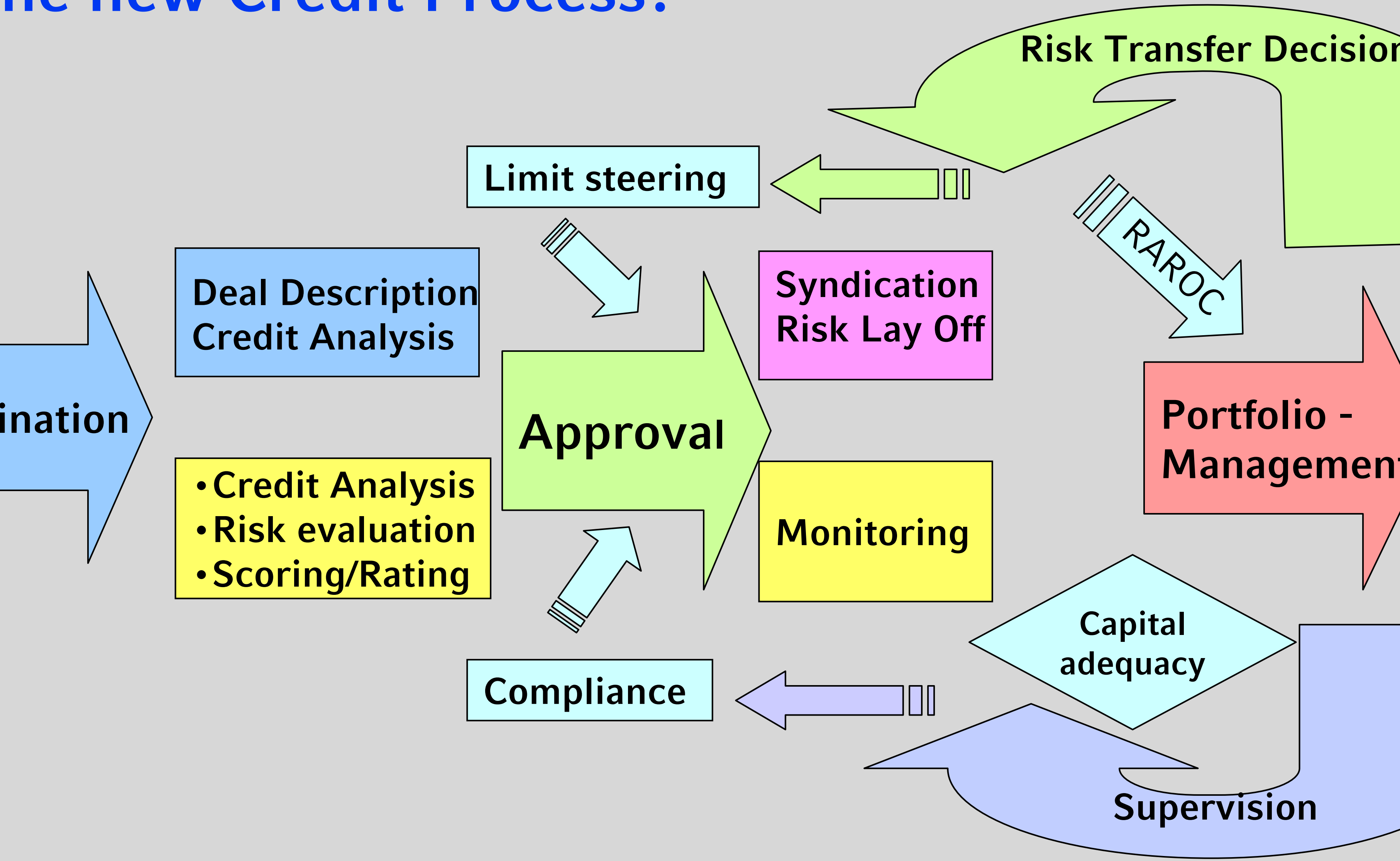
Differentiation

Systemisation

Transparency

Discipline

he new Credit Process?



he Basel II Accord - positive Effects?

Reduction of "human element" - good or bad?

Differentiated credit decision -Rating is key!

Establishment of appropriate credit procedures and early warning systems

Supervision and regular reviews of credit policy

he Basel II Accord - Uncertainties?

Cumbersome implementation of the accord

High administrative requirements

Complex and costly scoring and rating process

Data base inappropriate (PD,LGD)

Long transition

he Basle II Accord - Market Effects

Market Effects

- Correlation of quality of credit decision and capita costs!
- More conformity of credit policies?
- More risk-related pricing, less price competition?
- More Specialisation?
- Withdrawal of banks, further concentration?

ther Developments

- Two other aspects having an impact on the credit process:
  - Compliance Aspects and Money Laundering Prevention (MLP)
  - Environmental and Sustainability Aspects
- Concern = Reputational Risk

MLP and Compliance - the FATF

The FATF (Financial Action Task Force on Money Laundering has 33 Members

- Argentina
- Australia
- Austria
- Belgium
- Brazil
- Canada
- Denmark
- European Commission
- Finland
- France
- Germany
- Greece
- Gulf Co-operation Council
- Hongkong
- Iceland
- Ireland
- Italy
- Japan
- Luxemburg
- Mexico
- Netherlands
- New Zealand
- Norway
- Portugal
- Russian Federation
- Singapore
- South Africa
- Spain
- Sweden
- Switzerland
- Turkey
- UK
- USA

MLP and Compliance   the FATF

- **Purpose**: to develop and promote policies on national and international levels to combat money laundering and terrorist financing

- **Actions:**
  - monitors members' progress in implementation of measures
  - Reviews money laundering and terrorist financing techniques
  - Promotes adoption and implementation of appropriate measures globally
  - Issued 40 Recommendations (reviewed in 2003)
  - Issued 8 special Recommendations on Terrorist Financing

MLP Customer Due Diligence

the **KYC** (Know your Customer) standards

- Customer Acceptance Policy
- Customer Identification
  - Includes beneficial Owners
  - Beneficiaries of the transaction
  - Other related persons
- Ongoing monitoring of accounts and transactions
- Risk management
  - Responsible team
  - Training off staff
  - Appropriate procedures

ustainability Aspects

multilateral institutions (Worldbank, IFC, EBRD etc.) have statutory requirements to conduct environmental due diligence and apply an environmentally conscious credit policy, which had an impact on selection of projects

Until recent commercial banks have not put special emphasis o sustainability aspects

In Summer 2003 a group of major commercial banks has adopted the Equator Principles for project finance

ustainability Aspects   the Equator Principles

The Equator Principles

Form a voluntary commitment to apply certain environmental screening and risk management procedures
Refer to guidelines established by Worldbank and IFC
are Principles to be applied in Project Finance transactions above USD 50 million

ustainability Aspects   the Equator Principles

Environmental screening of projects to be financed

Project classification into one of three categories

- Category A
  likely to have significant adverse environmental impacts
- Category B
  site-specific impacts and mostly not irreversible
- Category C
  minimal or no adverse environmental impact

ustainability Aspects the Equator Principles

- **Category A** only if:
  - Completion of an Environmental Assessment (EA)
  - Environmental Management Plan (drawing on the conclusion of the EA)
  - Appropriate consultation with project affected groups (f.e. NGOs)
  - Borrower is committed to EMP in the construction and operation of the project
  - As necessary, independent experts for monitoring and reporting appointed
- **Category B**
  - Completion of EA
  - Other measures as appropriate
- **Category C** - no Action required

ustainability

Institutions which have adopted the Equator Principles

- ABN Amro Bank
- Bank of America
- Barclays plc
- BBVA
- Calyon
- CIBC
- Citigroup Inc.
- Credit Siuisse Group
- Dexia Group
- Dresdner Bank
- EKF
- HSBC Group
- HVB Group
- ING Group
- KBC
- MCC
- Mizuho Corporate Bank
- Rabobank Group
- Royal Bank of Canada
- Standard Chartered Bank
- The Royal Bank of Scotland
- WestLB AG
- Westpac Banking Corporation

onsequences for the Client Relationship

redit Process will be

- Longer
- more differentiated
- more complicated
- more transparent
- more comparable

anks will require

- Understanding
- Patience
- Cooperation
- Anticipation

Thank You !