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| <b>Client</b> | The client is a leading international bank offering custody and investment services primarily to investment funds and financial institutions |
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| <b>Project Name</b> | Credit process enhancement within completion of Basel II AIRB application, including the review of credit risk equivalent measurements for global exposure monitoring |
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| <b>Project Start Date</b> | January 2009 | <b>Project End Date</b> | April 2009 |
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| <b>Industry</b> | <input type="checkbox"/> Commercial banking                            | <input type="checkbox"/> Insurance                   |
|                 | <input checked="" type="checkbox"/> Fund Custody & Investment Services | <input type="checkbox"/> Investment banking          |
|                 | <input type="checkbox"/> Private banking                               | <input type="checkbox"/> Asset and wealth management |
|                 | <input type="checkbox"/> Retail banking                                |  |
|                 |  | <input type="checkbox"/> Corporate                   |

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| <b>Category of Service</b> | <input type="checkbox"/> Performance measurement and monitoring | <input type="checkbox"/> Regulatory compliance and reporting |
|                            | <input type="checkbox"/> Portfolio risk management              | <input type="checkbox"/> Business process improvement        |
|                            | <input checked="" type="checkbox"/> Specialised risks           | <input type="checkbox"/> Training and people change          |
|                            | <input type="checkbox"/> Data Quality                           | <input type="checkbox"/> System selection and implementation |

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| <b>The Challenge</b> | <p>The client is in the process of completing the global implementation of its Basel II AIRB approach for counterparty risks (financial counterparties and investment funds).</p> <p>In order to ensure proper integration of the AIRB approach in the day-to-day activity, a whole array of credit processes and monitoring tools needed to be upgraded. The client asked advantage to recommend, agree, and implement an enhanced and consistent methodology for the measurement of credit risk exposure equivalent (CREs) for banking book products. The revised CREs would (a) enhance the day to day credit risk limit monitoring, (b) allow group-wide consistent measurement of global exposure risk and consolidated reporting, and (c) be compliant with the Basel II framework, including “use test” requirements.</p> <p>The core challenge was to propose pragmatic CRE formulas taking resource (IT and human) constraints into account. advantage was also asked to support the development of a consensus view regarding the Group’s appetite for counterparty risk.</p> <p>Upon successful of the above phase, advantage was requested to develop and implement enhanced credit risk monitoring reporting based on the revised CRE indicators.</p> |
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| <b>Approach and Solution</b> | avantage’s approach was to anchor the solution around Basel II requirements, i.e. deriving the CRE from the current exposure and comprehensive approach |
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|  | <p>formulas provided for exposure at default (EAD), yet adopting more conservative parameters than the supervisory ones in line with the group’s risk appetite.</p> <p>With regard to the foreign exchange contracts specifically, avantage reviewed the relationship between limit consumption and the scale underlying exposure to assess the reliability or else of supervisory add-ons. A pragmatic periodic review of haircut and add-on parameters was proposed as a follow-up to ensure the ongoing adequacy of the CRE indicators.</p> <p>With regard to reporting, avantage proposed incorporating PDs, LGDs, internal ratings in the day-to-day monitoring tools in order to pave the way for the adoption of AIRB. In addition, indirect exposure measurement was added to the specifications of the Global Exposure Management System (e.g., exposure per currency, per underlying collateral type).</p> |
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| <b>Results and Benefits</b> | <p>The client was provided with a harmonized set of pragmatic CRE indicators for all existing banking book products, and a set of related parameters, ready to be implemented in the Global Exposure Management System, until more refined internal models are proposed. The Basel II compliant framework facilitated the supervisor’s review of use tests and AIRB integration. The use of regulatory standards as a foundation also provided an undisputed reference for the setup of CREs on new products in the Group without committing to costly internal model developments. The upgraded reports enhanced the credit risk monitoring process.</p> |
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| <b>Software used</b> | Not applicable. |
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