SCS-based Training Package on
Credit Risk Management for Banking Industry

Core Level
Module 1 to Module 3
of
Enhanced Competency Framework – Credit Risk Management

2024

Table of Contents

A. INTRODUCTION

The Enhanced Competency Framework on Credit Risk Management (ECF-CRM)[1] establishes a set of common and transparent competency standards for raising and maintaining the professional competence of relevant practitioners (RPs) of the credit risk management function in authorized institutions (AI). This framework enables talent development and facilitates the enhancement of professional competencies and capabilities of those staff engaged in the credit risk management function.

The Training Package on Credit Risk Management (CRM) for Banking Industry is based on the selected Units of Competency (UoC) of the Corporate and Commercial Banking Specification of Competency Standards (SCS) (Version 2) developed by the Banking Industry Training Advisory Committee. The performance requirements in the UoC are applied to the learning outcomes of the Training Package, and the learning and assessment materials correspond with the learning outcomes. It is developed for the specific learner profile, learning mode, and assessment method, which can be used as a reference in module designs.

The Training Package outlines the essential elements for Modules 1, 2 and 3, which correspond with those of ECF-CRM. It offers for reference the learning, assessment guidelines, as well as supporting and reference materials. The Training Package exemplifies the design of the modules' structure and comes with suggestions on teaching, learning, and assessment materials. Assessment materials include sample tasks, methods, contexts of assessment, outcome standards, and performance rubrics that are appropriate to the learning.

The Training Package is not meant to be a complete learning programme by itself. Enterprises and education and training providers who wish to use it as a blueprint for module development should adjust the relevant teaching, learning, and assessment contents for any variations in learning objectives, target learners, entry requirements such as academic level and experience, etc. In addition, users are advised to check and adopt the latest update of the references to ensure that they are current, valid, and accurate. For any learning programme developed by drawing reference to the Training Package to become Qualification Framework (QF)-recognised, it must successfully pass the quality assurance process of the Hong Kong Council for Accreditation of Academic and Vocational Qualifications (HKCAAVQ) or the self-accrediting institutions.

[1] ***Source: Extracted from HKMA Enhanced Competency Framework*** (Enhanced Competency Framework on Credit Risk Management (hkma.gov.hk))

B. USER GUIDE

This section elucidates the flow, basics, concepts, and assumptions of the design of the Training Package. The training organizers, training programme designers and trainers (collectively named as "Users") will find practical guidance[2] on using the Training Package for development into modules of learning or delivery of training.

1 Flow

The Training Package gives the overview and suggested structure of Modules 1 to 3, followed by the recommended resources requirement on teaching and learning, including but not limited to the qualifications of the trainers, the learning and teaching guide, assessment guide, and supports materials.

2 Basics

The Training Package design includes:

- expert opinions and experience of credit risk management, business management, and human resources management professionals solicited via
    - face-to-face interviews
    - electronic surveys
    - face-to-face work meetings, and
- validated with information from publicly available resources including but not limited to
    - the Hong Kong Monetary Authority (HKMA) framework on ECF-CRM
    - the HKMA Supervisory Policy Manual (SPM)

3 Concepts

The training package is best to evolve with time. learners can achieve the intended learning outcomes (ILO) with the learning and assessment activities built around credit work cases, publicly known credit cases and simulation cases.

4 Assumptions

The Training Package design assumes continuous support from the employers allowing learners to complete the applicable self-study, pre-class refreshers and assessment, the class, the end-of-class assessment, and the post-class simulation case.

[2] Learners may also find the training package relevant for researching on self-learning materials.

5 Users

The Training Package targets the Users in Sections 5.1 and 5.2 who find value in various sections for their work.

5.1 Training Programme Organizers

Training programme organizers include human resources/training department, enterprises, and vocational and professional education and training providers intend to host a new SCS-based training programme based on the Training Package.

Where applicable, these Users may also consider making an application to have the above programme accredited by HKCAAVQ based on the council's requirements.

5.2 Training Programme Designers and Trainers/Assessors

Training programme designers and trainers/assessors intend to design materials for and facilitate a SCS-based training programme based on the Training Package.

6 Guide to Different Users

The module sequence follows the ECF-CRM-suggested Modules 1, 2, and 3. The learners[3] will have the best learning effectiveness to acquire knowledge and skills in Modules 1 and 2 before Module 3. For Modules 1 and 2, the impact of the learning sequence is neutral.

The Training Package has dedicated sections, as indicated in Section 6.1 and 6.2 for each category of Users who find value in various sections for their work.

6.1 Training Programme Organizers

Training programme organizers will find value in the following sections:

Section C – Scope, Target Learners and Trainers: for the scope and coverage, target learners and entry requirements, trainers/assessors, and ratios of trainers/assessors and learners.

Section D – Structure: for the hierarchy of structure, ILO, modules, and submodules, level of learning, and volume of learning.

6.2 Training Programme Designers and Trainers/Assessors

Training programme designers and trainers/assessors will find value in the following sections:

Section E - Learning and Teaching Guide: for suggested learning submodules, learning modes and methods, learning contexts, the format of teaching, learning activities, time allocation, and learning facilities recommended.

Section F - Assessment Guide: for mapping assessment tasks with corresponding ILO, assessment methods, assessment activities, criteria and rubrics, performance grade, and passing criteria.

Section G - Support Materials for Trainers: for reference notes, suggested self-study reading materials, books and optional reading materials.

[3] Learners looking for self-study materials will find values in Section G (4) Support Materials - Learner's Self-study and Extended Learning for valuable reading materials to support the development of competencies aligned with ILO of Modules 1, 2, and 3.

1.1 QF Credits

QF credit is a common currency to enhance the transparency of programme. Under QF, one credit consists of 10 notional learning hours.

7 Volume of Learning

This section outlines the educational commitment via QF Credits and Notional Learning Hours, detailing expected self-study, practical time, and module-specific allocations for achieving learning outcomes.

2.1 Notional Learning Hours

Notional learning hours (NLH) to be spent by an average learner, in all modes of learning, includes attendance in self-study, online education, classes, assessment/examination, practical learning with work cases/simulation cases, etc., to achieve the programme's learning outcomes. In the Training Package, NLH indicates the volume of learning.

2.2 NLH Allocation by Module

Modules 1, 2, and 3 are on a knowledge, skills, and behaviours continuum. The learners' successful completion of the required self-studies, classroom learnings, assessments, and extended learning of Module 1 and 2 equips them with the necessary range of performance capability, building a solid foundation for the efficient apprehension of the theoretical and practical aspects of Module 3. Together with the proposed learning activities, the learners achieve learning outcomes of performance requirements within the suggested NLH. The suggested NLH for an average learner to achieve the ILO of Modules 1, 2, and 3 are 260, 150, and 185, respectively, with the details shown in the table below.

8 Overview

8.1 Suggested Program Structure

Module 1		**Module 2**		**Module 3**	
Credit Risk Management and Key Regulations		Fundamental Credit Risk Analysis		Fundamentals of Bank Lending	
Sub-modules					
1-Early Warning Signal 2-Risk Mitigation 3-Manage and Control the Risk 4-Stress Testing 5-Account Monitoring and Problem Loan	40 40 40 40 100	1-Financial Analysis 2-Financial Strength Assessment 3-Credit Risk Assessment and Structure Credit Facility	40 40 70	1-Credit Facility Structure of Bank Products for large and complex clients 2-Consultation, Presentation, Negotiation and code of ethics	105 80
Total After integration	**260**	Total After integration	**150**	Total After integration	**185**
Content					
1-Monitoring of portfolio -Theory and practice 2-Identify -Early warning signal -Needs for risk mitigants -Relevant credit risk 111indicators -Vulnerable sectors in the portfolio -Delinquent payment's root causes 3-Identify the relationship of the risk level change with loan provision 4-Identify key regulations, report remedy and make recommendations		1-Accounting concepts 2-Financial ratio 3-Limitation of financial statements 4-Business drivers 5-Critical analysis of financial statements -Internal factors -External factors -Business model 6-Cash budget analysis and financial strength 7-Budget and pro-forma analysis 8-Quantitative analysis and risk assessment 9-Structure credit facility		1-Bank products 2-Financial solutions customization 3-Credit facility structure 4-Collateral valuation and relevant associated loan risk 5-Pricing and affordability 6-Evaluation of credit acquisition 7-Overivew: ethics, behavioral knowledge and skills 8-Consultation 9-Presentation 10-Negotiation	
Learning Mode 1 – Self Study					
1-Reading materials 2-Self-assessment 3-Improvement suggestion on credit guidelines 4-Presentation preparation		1-Reading materials 2-Self-assessment 3-Improvement suggestion on credit guidelines 4-Presentation preparation		1- Reading materials 2-Self-assessment 3-Improvement suggestion on credit guidelines 4-Presentation preparation 5-Refreshers	
Learning Mode 2 – Class					
1-Intended learning outcomes 2-Introduction 3-Newsroom 4-Learning content 5-Practice -Case presentation -Case drill 6-Assessment -Short questions -Long questions -Case-based questions 7-Seminar on key regulations, credit risk operations and compliance and topical sharing -Key regulations -Case related to credit operational risk -Loan classification -Capital adequacy and provisioning -Collateral authentication -Stress testing design overview -Contingency plan overview -ESG financing overview		1-Intended learning outcomes 2-Introduction 3-Newsroom 4-Learning Content 5-Practice -Case presentation -Case drill 6-Assessment -Short questions -Long questions -Case-based questions		1-Intended learning outcomes 2-Introduction 3-Newsroom 4-Learning content 5-Practice -Case presentation -Case drill 6-Assessment -Short questions -Long questions -Case-based questions and skill assessment 7-Seminar on cases about -Credit structure of complex products for complex clients	
Learning Mode 3 - Case					
Simulation case		Simulation case		Simulation case	

8.2 Suggested Program Roadmap[4]

	Module 1	Module 2	Module 3
Submodule 1	Early Warning Signal	Financial Analysis, Customer Needs Identification and Evaluation on Suitability	Credit Facility Structure of Bank Products for Large and Complex Clients
Submodule 2	Risk Mitigation	Financial Strength Assessment	Consultation, Presentation, Negotiation and Code of Ethics
Submodule 3	Manage and Control risk	Credit Risk Assessment and Structure Credit Facility	
Submodule 4	Stress Testing		
Submodule 5	Account Monitoring and Problem Loan		

[4] The credit facilities expressively stated in the Unit of Competencies categorized as level 6 are excluded from Modules 1, 2 and 3 development, examples are large amount credit facilities including real estate development loan/construction finance, large scale production plant financing, provision of customized financial arrangement related to configuration of loan hedging relevant products, as well as the credit facilities involving more than one participating lender, dedicated to large-cap corporations, financial institutions, governments and large multi-nationals.

C. SCOPE, TARGET LEARNERS, AND TRAINERS

1 Scope and Coverage

1.1 Scope - Units of Competency

The following UoC are selected to direct the Training Package. Performance requirements of UoC are at Appendix One.

Module 1

109271L4 Monitor the risk level of the loan portfolio to identify early risk signal
109266L5 Develop risk mitigation strategies for the credit portfolio
109267L5 Conduct stress testing and analyse the results
109268L5 Manage and control the risks of the credit assets for enterprise banking
109270L5 Conduct ongoing monitoring of borrowing accounts
109273L5 Conduct post approval credit monitoring and review on problem loans
109319L5 Develop internal policies, guidelines, and standards for different operations to comply with regulatory requirements

Module 2

109256L5 Review risk assessment on credit application
109257L5 Structure the credit facility
109260L5 Assess credit and financial strength of borrower and prepare credit proposal
109502L5 Conduct company financial analysis to identify client needs

Module 3

109257L5 Structure the credit facility
109258L5 Evaluate the performance of credit acquisition and make suggestions
109259L5 Provide consultancy service to clients on credit risks
109260L5 Assess credit and financial strength of borrowers and prepare credit proposal
109269L5 Evaluate market value and marketability of collateral and identify the risk associated with the loan
109293L5 Structure credit facilities for large scale operating assets financing programmes
109502L5 Conduct company financial analysis to identify clients' needs
109503L5 Present financial solutions to general enterprise banking clients
109504L5 Negotiate with the clients to finalize the customized financial solutions

1.2 Coverage - Job Roles

The Training Package is intended to cover the following job roles of RPs. RPs refer to those who are engaged by banks undertaking commercial credits business for borrowers ranging from large to medium and small enterprises.

Core Level (Entry-, junior-level staff in credit function)	**Role 1 Credit Initiation and Appraisal**	**Role 2 Credit Evaluation, Approval and Review**	**Role 3 Credit risk management and Control**
Examples of functional title for reference only	Credit officer, associate/assistant credit initiation manager, relationship officer	Credit acquisition officer, credit underwriter, credit analyst	Credit risk officer
Role Description	Assist in performing credit initiation of commercial lending within established policies Assist in assessing borrower's credit and financial information for preparing credit proposals Assist in assessing borrowers' credit ratings Assist in monitoring borrowers' accounts	Assist in assessing borrowers' repayment ability after evaluation of various risks and suitability of credit package based on the credit proposals Assist in conducting independent review of borrower's credit rating/loan classification Assist in assessing quality of collateral and other types of risk mitigations and comforts. Assist in evaluating and approval loan application	Assist in formulating and reviewing credit policies Assist in monitoring credit accounts, credit risks, and preparing analytical reports to management Assist in performing assessment and gap analysis according to regulatory and management requirements regarding calculations of risk indicators and portfolio performance indicators Assist in performing analysis on credit limits and monitoring credit portfolios Assist in handling the recovery and work-out of problem loans/ deteriorating credit

Source: Extracted from HKMA Enhanced Competency Framework (Enhanced Competency Framework on Credit Risk Management (hkma.gov.hk))

2 Target Learners and Entry Requirements

2.1 Target Learners

The training programme is suitable for banking employees who want to advance their knowledge, skills, and behaviours on credit risk management in commercial banking.

2.2 Entry Requirements

To apply for admission to the programme, it is suggested that applicants should have obtained one of the following:

- A bachelor's degree in any discipline awarded by a recognized university or equivalent, OR
- An associate degree/higher diploma in a banking and finance discipline or equivalent; OR
- A relevant professional qualification; OR
- Three years of banking experience in any front, middle or back-office departments, including client relationship, middle office, transaction banking, structured products, and supporting functions[5] for Modules 1 and 2 enrollments; AND have completed Modules 1 and 2 for Module 3 enrollment.

[5] Organizational structure, Progression Pathway – corporate and commercial banking (Example) https://hkqf.gov.hk/files/page/banking-vqp/1/Banking_VQP%20diagram_Corporate%20and%20Commercial%20Banking-1706080313.pdf

3 Trainers/Assessors

3.1 Requirements

RP with a minimum of eight years of relevant experience and currently engaged in relevant roles (e.g., credit initiation and appraisal, credit evaluation, approval and review, credit risk management, and control) can be trainers.

Trainers with a minimum of ten years of previous teaching/training experience for banks or corporate executives, can be trainers, as long as there is experience in teaching/training related topics. Trainers with a postgraduate degree in finance, or risk management, or professional qualifications such as CPA, CFA, FRM are preferred.

A trainer may also deliver updates on the following suggested topics in Modules 1 and 3

For Module 1

- Key regulations
- Cases related to credit operational risk
- Loan classification
- Capital adequacy and loan provisioning process
- Collateral authentication
- Stress testing design overview
- Contingency plan overview
- ESG financing overview

For Module 3

- Credit structure of complex product for complex clients

Alternatively, trainers may arrange guest speakers to share updates on the above topics.

3.2 Assessor's Role

Trainers may also assume the role of assessors to collect and score assessment tasks or recruit assessors for specific assessment tasks.

4 Class Ratio

Trainer-to-learner ratio is 1: 15 – 20

D. STRUCTURE

1 Hierarchy of Structure

The Training Package consists of three Modules. Module 1 consists of five submodules, Module 2 consists of three submodules, and Module 3 consists of two submodules which are also the keys for learning, teaching, and assessment. The essential knowledge, skills, and behaviours for the submodules are organized into “content.” The table below lists out the suggested structure to which the Training Package is referred for development and design.

Module 1

Submodule	Content
1. Early Warning Signal	1. Monitor portfolio – theory and practice 2. Identify early warning signal 3. Identify the relationship of the risk level change with loan provision 4. Identify key regulations, report remedy, and make recommendations
2. Risk Mitigation	1. Monitor portfolio – theory and practice 2. Identify needs for risk mitigants 3. Identify the relationship of the risk level change with loan provision 4. Identify key regulations, report remedy, and make recommendations
3. Manage and Control the Risk	1. Monitor portfolio – theory and practice 2. Identify the relevant credit risk indicators 3. Identify the relationship of the risk level change with loan provision 4. Identify key regulations, report remedy, and make recommendations
4. Stress Testing	1. Monitor portfolio – theory and practice 2. Identify the vulnerable sectors in the portfolios 3. Identify key regulations, report remedy, and make recommendations
5. Account Monitoring and Problem Loan	1. Monitor portfolio – theory and practice 2. Identify delinquent payments’ root causes 3. Identify the relationship of the risk level change with loan provision 4. Identify key regulations, report remedy, and make recommendations

Module 2

Submodule	Content
1. Financial Analysis	1. Accounting concepts 2. Financial ratio 3. Limitation of financial statements 4. Business drivers
2. Financial Strength Assessment	5. Critical analysis of financial statements - Internal factors - External factors - Business models 6. Cash budget analysis and financial strength
3. Credit Risk Assessment and Structure Credit Facility	7. Budget and pro-forma analysis 8. Quantitative analysis and risk assessment 9. Structure credit facility

Module 3

Submodule	Content
1. Bank Products and Credit Facility Structure for Large and Complex Clients	1.Bank products 2.Financial solutions customization 3.Credit facility structure 4.Collateral valuation and relevant associated loan risk 5.Pricing and affordability 6.Evaluation of credit acquisition
2. Consultation, Presentation, Negotiation and Code of Ethics	7.Overview of Code of Ethics, behavioral knowledge and skills 8.Consultation Process 9.Presentation Process 10.Negotiation Process

2 Intended Learning Outcomes

Intended Learning Outcomes (ILO) are derived from the performance requirements of the UoC. ILO of Module 1 can be achieved through learning and applying comprehensive credit risk management theories and practices. ILO of Module 2 can be achieved through learning and applying comprehensive operational, financial, business, and internal analysis. The ILO for Module 3 can be achieved through learning and applying practical structure of credit facilities suited for large and complex enterprises and integrating knowledge and skills from Modules 1, 2 and 3 to shape consultation, presentation, and negotiation process.

By the end of this learning program, encompassing Modules 1, 2 and 3, learners will have developed a well-rounded proficiency in credit risk management, including a deep understanding of portfolios and accounts risk management, credit risk analysis of loan applications with thorough financial strength analysis, credit facility structure for large and complex clients, as well as being capable of engaging in consultation, presentation, and negotiation effectively. The cumulative knowledge, skills, and behaviours acquired will enable learners to meet the learning outcomes detailed in the tables below.

Module 1

Submodules	Overall Learning Outcomes
1. Early Warning Signal	Monitor the loan accounts and portfolios day-to-day to identify early warning signal
2. Risk Mitigation	Understand mitigation strategies and apply to different kinds of credit assets in the portfolio
3. Manage and Control Risk	Manage risk of credit assets and develop risk control measures/remedy
4. Stress Testing	Understand and conduct stress testing, analyze the results to identify vulnerable sectors in the portfolios
5. Account Monitoring and Problem Loan	Monitor the risk changes in accounts and portfolios and recovery and workout of problem loans

Module 2

Submodules	Overall Learning Outcomes
1. Financial Analysis	Apply financial and non-financial analysis to assess a client’s financial positions, needs and credit worthiness
2. Financial Strength Assessment	Analyze a client’s operational, financial, business, and internal factors to assess its financial strength, and review the client’s credit rating
3. Credit Risk Assessment and Structure Facility	Perform quantitative analysis about repayment capability, calculate potential losses, estimate risk-return, a preview on proposed credit structure for eligible client

Module 3

Submodule	Overall Learning Outcomes
1. Credit Facility Structure of Bank Products for Large and Complex Clients	Prepare comprehensive significant credit facility proposals with or without cross-border risk for large and complex clients with inter- and/or intra-company transactions, encompassing a variety of bank products and services that utilize balance sheet assets. This includes evaluating product-client suitability, assessing revenue-risk commensuration, identifying market value of various credit assets and collaterals, understanding the risk associated with corresponding loans and making suggestions to refine credit acquisitions.
2. Consultation, Presentation, Negotiation and Code of Ethics	Integrate the skills of consulting, presenting, and negotiating to cater to a wide range of enterprise needs, from general to large-scale enterprises: emphasizing on advising on credit risk across various segments, products, services and lending, engaging in consultative skills to identify client needs and evaluate the suitability of various enterprises for different lending options, presenting to engage clients on tailored financial solutions, and negotiation dialogues to enhance the bank's outcomes on value and protections, adhering to and promoting an established code of ethics throughout all interactions and transactions.

3 Intended Learning Outcomes Mapping Matrix

The ILO are stipulated in the UoC performance requirements. Mapping of submodules with the UoC performance requirements are presented in the following tables.

The training package includes Modules 1, 2, and 3, designed as a continuous learning journey. The knowledge, skills, and attitudes acquired in Modules 1 and 2 overlap with some performance requirements in Module 3. The suggested NLH for Module 3 reflects this learning efficiency, with a recommendation that learners invest pre-class NLH to review performance requirements from Modules 1 and 2, followed by a refresher to confirm the effectiveness of the review.

Module 1 - Mapping of Submodules with UoC Performance Requirements

109271L4

Monitor the risk level of the loan portfolio to identify early risk signal

Monitoring the risk exposures of the loan portfolio and reporting to senior management. It refers to day-to-day monitoring of the portfolio which covers monitoring of different types of risk.

Level: 4
Credit: 3

		UoC Performance Requirements								
		Knowledge		Application				Behavioural		
Module (M) Submodules (S)	**Content**	Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring.	Be able to understand the credit strategies and portfolio objectives of the bank in order to identify crucial areas for monitoring.	Monitor and ensure credit administration is in compliance with contractual requirements and facility terms.	Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios.	Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt actions.	Identify the sources and causes of the changes in risk level, e.g., underwriting standards, economic conditions, personnel issue and recommend appropriate corrective actions.	Demonstrate professionalism by applying impartial and unbiased judgment throughout the loan portfolio assessment process.	Regularly review the advantages and weaknesses of forecasting and reviewing approaches and adopt the most reliable measure.	Report to senior management about the results of analysis on risk profile of overall loan portfolio.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X	X	X	X	X	X	X
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X							
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X							
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations									
M1S5 A/C Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									

Module 1 - Mapping of Submodules with UoC Performance Requirements

109266L5 **Develop risk mitigation strategies for the credit portfolio** Developing strategies to minimize risks in the bank's credit portfolio. This applies to different kinds of assets in the bank's credit portfolio. Level: 5 Credit: 4		**UoC Performance Requirements**								
		Knowledge			**Application**					
Module (M) Submodules (S)	**Content**	Demonstrate professional knowledge in credit risk management in order to maintain an optimal risk level for credit portfolio.	Professional knowledge in credit management by utilizing different tools (e.g., setting exposure limits, credit derivative) in managing credit risk and their performance in different economic scenarios.	Understand the impacts on business environment caused by the changing external factors and apply the knowledge to evaluate current and future economic outlook and regulatory development for the purpose of developing suitable strategies in risk mitigation.	Evaluate the credit strategies and existing risk exposure of the bank in order to construct a suitable risk management approach.	Conduct analysis on the trends on risk level of the credit portfolio in order to identify critical factors which can affect the risk level.	Construct strategies in diversifying concentration risk, e.g., reducing exposures to particular type of loan, broaden customer base, altering product mix, industry etc.	Formulate measures to protect the bank from undue risk exposure by employing suitable techniques, e.g., asset sales, securitization, credit derivatives, etc.	Develop policies and procedures for applying different types of credit mitigation techniques.	Develop guidelines and standards on reporting to management when the aggregate exposure is approaching or exceeding portfolio limits.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X						
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X	X	X	X	X	X	X
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X						
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations									
M1S5 A/C Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									

Module 1 - Mapping of Submodules with UoC Performance Requirements

<table>
<tr><td colspan="2">109266L5
Develop risk mitigation strategies for the credit portfolio

Developing strategies to minimize risks in the bank’s credit portfolio. This applies to different kinds of assets in the bank’s credit portfolio.

Level: 5
Credit: 4</td><td colspan="2">UoC Performance Requirements
Behavioural</td></tr>
<tr><td>Module (M) Submodules (S)</td><td>Content</td><td>Manage the activities of credit risk mitigation strategies to ensure they are applied at the right time and used for their purported purposes.</td><td>Conduct regular review on the results of the mitigation instructions and provide suggestions on necessary changes.</td></tr>
<tr><td>M1S1
Early Warning Signal</td><td>-Monitor portfolio – theory and practice
-Identify early warning signal
-Identify the relationship of risk level change with loan provision
-Identify key regulations, report remedy and make recommendations</td><td></td><td></td></tr>
<tr><td>M1S2
Risk Mitigation</td><td>-Monitor portfolio – theory and practice
-Identify needs for risk mitigants
-Identify the relationship of risk level change with loan provision
-Identify key regulations, report remedy and make recommendations</td><td>X</td><td>X</td></tr>
<tr><td>M1S3
Manage and Control the Risk</td><td>-Monitor portfolio – theory and practice
-Identify the relevant credit risk indicators
-Identify the relationship of risk level change with loan provision
-Identify key regulations, report remedy and make recommendations</td><td></td><td></td></tr>
<tr><td>M1S4
Stress Testing</td><td>-Monitor portfolio – theory and practice
-Identify vulnerable sectors in the portfolios
-Identify key regulations, report remedy and make recommendations</td><td></td><td></td></tr>
<tr><td>M1S5
Account Monitoring and Problem Loan</td><td>-Monitor portfolio – theory and practice
-Identify delinquent payment’s root causes
-Identify the relationship of risk level change with loan provision
-Identify key regulations, report remedy and make recommendations</td><td></td><td></td></tr>
</table>

Module 1 - Mapping of Submodules with UoC Performance Requirements

109268L5
Manage and control the risk of the credit assets for enterprise banking

Conducting risk management and control of credit assets of the bank. This applies to different kinds of credit assets possessed by the bank.

Level: 5
Credit: 4

		UoC Performance Requirements							
		Knowledge		Application				Behavioural	
		Demonstrate professional knowledge in managing risk of credit assets by applying it to evaluate different risk management strategies for the purpose of designing a most suitable approach for the bank.	Understand the credit strategies and portfolio objectives of the bank in order to build an alignment between the selected risk management approach and the bank’ s strategies.	Assess the situation in order to identify the most suitable approach in risk management and develop the execution plan.	Design risk management measures to diversity risks into different uncorrelated or less correlated business.	Mitigate credit risk by acquiring security, insurance, third party guarantee, etc.	Identify factors affecting the value of the credit assets for assessing the purchase or selling price in order to quantify the risks.	Evaluate effectiveness of different approaches of risk management for the purpose of transferring or mitigating credit risk.	Review current risk management measures and provide suggestions on improvement based on results of evaluation on different approaches for transferring or mitigating credit risks.
Module (M) Submodules (S)	**Content**								
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations								
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X						
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X	X	X	X	X	X
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations								
M1S5 Account Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment’s root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations								

Module 1 - Mapping of Submodules with UoC Performance Requirements

109267L5 **Conduct Stress Testing and analyze the results** Conducting different types of stress testing at different complexity level. This applies to testing conducted on individual loans offered to clients or different portfolio segments. Level: 5 Credit: 4		**UoC Performance Requirements**								
		Knowledge			**Application**					
Module (M) Submodules (S)	**Content**	Possess specialized knowledge in stress testing and apply it to evaluate different methods of execution in order to develop a suitable approach for the bank.	Understand the credit strategies and portfolio objectives of the bank and based on that evaluate the existing portfolio of credit assets.	Understand the Current macroeconomic environment and trends and consider these as key factors of stress testing.	Identify factors (e.g., financial data, economic variables) that can impose effects on risk level of loan portfolio and develop financial models to quantify the sensitivity of loan performance to different scenarios.	Analyse existing performance/potential risks of the portfolio in order to determine the objectives for stress testing.	Design methodology, analysis framework and tools on stress testing which are aligned with the objectives of the testing.	Develop testing plan and conduct the test by altering assumptions in different variables and record the effect on portfolio credit quality. .	Analyse the performance of different assets and liabilities under the various hypothetical scenarios.	Analyse the results of stress testing and identify the vulnerability of different segments of loan portfolio.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									
M1S3 Manage and Control the Risk	-Monitor portfolio - theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		X	X						
M1S4 Stress Testing	-Monitor portfolio - theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations	X	X	X	X	X	X	X	X	X
M1S5 A/C Monitoring and Problem Loan	-Monitor portfolio - theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									

Module 1 - Mapping of Submodules with UoC Performance Requirements

109267L5 **Conduct Stress Testing and analyse the results** Conducting different types of stress testing at different complexity level. This applies to testing conducted on individual loans offered to clients or different portfolio segments. Level: 5 Credit: 4		**UoC Performance Requirements**	
		Behavioural	
Module (M) Submodules (S)	**Content**	Consolidate the results of stress testing into the risk management process and develop suitable measures.	Develop contingency plans for vulnerable segments. e.g., strengthening the supervision process, imposing limits, devising existing strategies.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		
M1S4 Stress Testing	-Portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations	X	X
M1S5 Account Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		

Module 1 - Mapping of Submodules with UoC Performance Requirements

109270L5 **Conduct ongoing monitoring of borrowing accounts** Monitoring borrowing accounts transactions regularly or in real time for risk by using different kinds of analysis methods to cover areas on banking practice, commercial credit management, clients' corporate governance, clients' business and industrial trends and regulatory requirements. This applies to different types of enterprise banking loans accounts. Level: 5 Credit: 4		**UoC Performance Requirements**									
		Knowledge			**Application**					**Behavioural**	
Module (M) Submodules (S)	**Content**	Demonstrate proficient knowledge in risk management in order to identify the most appropriate method in borrowing account risk monitoring.	Understand the process of credit monitoring and evaluate the performance of client's accounts to compare with the credit strategies and portfolio objectives of the bank to identify critical areas for further follow-up actions.	Keep up to date on the future development and current performance of clients' business/ participating industry.	Analyse client's historical information, account profile, account activities/pattern, business outlook, predicted future activity, financial and business data, etc. for identifying risk levels.	Monitor indicators of credit quality (e.g., delinquency, risk rating trends) and identify changes in risk characteristics of loan portfolio.	Perform on-site inspection and regular due diligence review to identify early signals or delinquency.	Analyze the customers, products activity and financial transactions profile of bank clients to track if any irregularities occur.	Monitor clients' borrowing accounts and advise them of new or alternative services to meet their changing needs.	Be able to identify causes and sources of risks and report to appropriate parties for prompt remedial actions.	Be able to restructure debts of clients to improve clients' financial stability and solvency, when it is necessary.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations										
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations										
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations										
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations										
M1S5 A/C Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X	X	X	X	X	X	X	X

Module 1 - Mapping of Submodules with UoC Performance Requirements

109273L5

Conduct post approval credit monitoring and review on problem loans

Conducting on going credit monitoring on loan accounts and reviewing problem loans to identify the underlying causes. This applies to loans of different kinds, amount and client segments.

Level: 5
Credit: 4

		UoC Performance Requirements								
		Knowledge		Application					Behavioural	
Module (M) Submodules (S)	**Content**	Understand theories and knowledge in bank lending in order to analyse the situation in different cases of problem loans.	Demonstrate professional knowledge in problem loans management (e.g., common causes for problem loan, early warning signals) by applying it to identify the root causes of different problem loans.	Evaluate the repayment record and transaction records of different accounts of the clients in order to identify possible causes for delay in payment.	Review the accuracy of past documentation (e.g., collateral valuable report, risk assessment, tracking report) and timeliness of problem identification in order to identify possible root causes or problem loans.	Consolidate information from different sources in order to analyse the changes in financial situations of the clients when compared to the time of loan origination.	Compare the loan with lending guidelines to identify any deviation from the agreed principles.	Determine the amount of provision for problem accounts and assess the impact on the bank' s credit portfolio.	Evaluate information related to current and projected financial status of applicants, hence, to re-assess the bank/client relationship and carry-out necessary follow-up actions promptly.	Classify the unpaid debt customers to make claims and provide necessary information to relevant parties, if warranted.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations									
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations									
M1S5 Account Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X	X	X	X	X	X	X

Module 1 - Mapping of Submodules with UoC Performance Requirements

109319L5
Develop internal policies, guidelines and standards for different operations to comply with regulatory requirements

Setting of compliance policies, guidelines and standards for different operations of the bank. This applies to different regulations related to the banking industry.

Level: 5
Credit: 4

		UoC Performance Requirements								
		Knowledge		Application						
Module (M) Submodules (S)	**Content**	Demonstrate professional knowledge in banking law in order to identify the requirements of different regulations.	Possess knowledge in rules and regulations related to banking operations (e.g., framework issued by Basel Committee on Banking Supervision and requirement of HKMA Supervisory Policy Manual, etc.) and apply it to evaluate the relevant regulations and identify the effects on the bank’ s policies, procedures and operation as appropriate.	Evaluate the business/operations of the bank in order to assess whether they can fulfil the regulatory requirements.	Review the existing level of compliance risks and identify possible scenarios of breaches of law in order to formulate control measures.	Review the probability and possible consequences of non-compliance when designing the control measures.	Develop the scope and objective of internal standards based on the review findings.	Specify the handling methods of dealing with different scenarios of non-compliance based on the estimated consequences and impacts to the bank.	Design effective internal reporting systems to provide management with updated information on compliance.	Establish escalation procedures for reporting different types of non-compliance issues to internal parties or regulatory bodies.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		X				X		X	X
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		X				X		X	X
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations		X	X	X	X	X	X	X	X
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations		X				X		X	X
M1S5 Account Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment’s root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X				X		X	X

Module 1 - Mapping of Submodules with UoC Performance Requirements

109319L5 **Develop internal policies, guidelines and standards for different operations to comply with regulatory requirements** Setting of compliance policies, guidelines and standards for different operations of the bank. This applies to different regulations related to the banking industry. Level: 5 Credit: 4		**UoC Performance Requirements**		
		Behavioural		
Module (M) Submodules (S)	**Content**	Formulate internal standards by stating practices acceptable/required by the bank and ensure the standards set are in proportionate with the level of risk exposure.	Propose internal compliance policies, guidelines and standards which can maintain a proper balance between compliance with statutory requirements and operational efficiency.	Take actions to ensure existing framework is adequate to safeguard the bank from regulatory risk.
M1S1 Early Warning Signal	-Monitor portfolio – theory and practice -Identify early warning signal -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X		
M1S2 Risk Mitigation	-Monitor portfolio – theory and practice -Identify needs for risk mitigants -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X		
M1S3 Manage and Control the Risk	-Monitor portfolio – theory and practice -Identify the relevant credit risk indicators -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X	X	X
M1S4 Stress Testing	-Monitor portfolio – theory and practice -Identify vulnerable sectors in the portfolios -Identify key regulations, report remedy and make recommendations	X		
M1S5 Account Monitoring and Problem Loan	-Monitor portfolio – theory and practice -Identify delinquent payment's root causes -Identify the relationship of risk level change with loan provision -Identify key regulations, report remedy and make recommendations	X		

Module 2 - Mapping of Submodules with UoC Performance Requirements

<table>
<tr><td colspan="2" rowspan="3">109502L5
Conduct company financial analysis to identify clients' needs

Conducting different kinds of analyses to evaluate the company performance of banking facilities applicants as part of the account planning process. This involves reviewing of different financial reports of the clients and applies to different kinds of lending to small and medium sized enterprises

Level: 5
Credit: 4</td><th colspan="10">UoC Performance Requirements</th></tr>
<tr><th colspan="2">Knowledge</th><th colspan="5">Application</th><th colspan="3">Behavioural</th></tr>
<tr><td rowspan="2">Demonstrate in-depth knowledge on company financial analysis by applying it to evaluate different common methodologies within the bank's framework in analyzing company performance and to develop a suitable approach for assessing the current banking facility application.</td><td rowspan="2">Demonstrate professional knowledge in the client's industry, e.g., key terms and terminology, performance indicators for analysis, business cycle, competitive landscape, latest development, etc. in order to identify focus and scope of company analysis.</td><td rowspan="2">Identify information useful for understanding the business and employ different approaches to obtain the relevant information for account planning purpose (e.g., send request to clients, industry practitioners, etc.)</td><td rowspan="2">Consolidate relevant financial data and evaluate financial position of client by analyzing financial statements, business contracts, ageing reports, and etc.</td><td rowspan="2">Analyse the strategic direction and major business initiatives to identify the future potential, challenges and opportunities of the company.</td><td rowspan="2">Evaluate the business models and identify factors that may impose significant effect on their earnings and cost structures hence to predict the prospect of the business.</td><td rowspan="2">Assess the risk of potential financial loss that doing business with the client, ultimately determining whether to offer the credit facilities.</td><td rowspan="2">Identify key forces shaping the industry of the clients' businesses and learn from the accuracy of historical forecasts to make adjustments to the assessment methods.</td><td rowspan="2">Analyse the value chain of the business and adopt a holistic consideration to assess opportunities and risks associated with the client's operations.</td><td rowspan="2">Compare the performance, business model and operations of the clients with companies of similar size in the same industry hence to produce a fair judgement.</td></tr>
<tr><th>Module (M)
Submodules (S)</th><th>Content</th></tr>
<tr><td>M2S1
Financial Analysis</td><td>-Accounting concepts
-Financial ratios
-Limitation of financial statements
-Business drivers</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>M2S2
Financial Strength Assessment</td><td>-Critical analysis of fin. statements
• Internal factors
• External factors
• Business model
-Cash budget analysis and fin. strength</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>M2S3
Credit Risk Assessment and Structure Credit Facility</td><td>-Budget and pro-forma analysis
-Quantitative analysis and risk assessment
-Structure credit facilities</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Module 2 - Mapping of Submodules with UoC Performance Requirements

109256L5
Review risk assessment on credit application

Reviewing risk assessment approaches on credit application. This applies to risk assessment using in-depth analysis on individual applications which usually covers loan involving significant amount such as project finance, corporate financing, and ordinary enterprise banking loans, etc.

Level: 5
Credit: 4

		UoC Performance Requirements									
		Knowledge			**Application**						
Module (M) Submodules (S)	**Content**	Demonstrate expert knowledge in theories and concepts across different areas of corporate finance in order to assess the risks of loan application.	Understand the characteristics of different credit products offered by the bank and apply the knowledge to compare and contrast features of them in order to judge the suitability of loan applicants.	Possess knowledge on the bank's business portfolio and conduct research on factors affecting default risks and assess the probability and impacts of default.	Interpret research findings or other information on macroeconomic environment and industry analysis in order to assess business outlook and possible risks of the applicants' business.	Evaluate financial statements and identify incomplete information in order to have an accurate and comprehensive analysis on the financial standing of borrower (need for securities).	Evaluate liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations in order to identify discrepancies or suspicious statements/reports.	Evaluate and select the most suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of the businesses or projects.	Conduct site visit to verify the authenticity of information submitted and obtain additional information for assessment.	Conduct credit risk assessment by evaluating the business risk, financial risk and total corporate risk of the businesses/projects in consideration.	Estimate the degree of risk involved in extending credit or lending money by consolidating information from different analysis (e.g., track record, business performance, collateral values).
M2S1 Financial Analysis	-Accounting concepts -Financial ratios -Limitation of financial statements -Business drivers										
M2S2 Financial Strength Assessment	-Critical analysis of fin. statements • Internal factors • External factors • Business model -Cash budget analysis and fin. strength	X	X	X	X	X	X		X	X	
M2S3 Credit Risk Assessment and Structure Credit Facility	-Budget and pro-forma analysis -Quantitative analysis and risk assessment -Structure credit facilities							X			X

Module 2 - Mapping of Submodules with UoC Performance Requirements

109256L5 **Review risk assessment on credit application** Reviewing risk assessment approaches on credit application. This applies to risk assessment using in-depth analysis on individual applications which usually covers loan involving significant amount such as project finance, corporate financing, and ordinary enterprise banking loans, etc. Level: 5 Credit: 4		**UoC Performance Requirements**		
		Behaviours		
		Provide recommendations on whether the current assessment methods satisfy the changing lending criteria of the banks.	Recommend revised assessment criteria and approaches for determination of approval (with or without condition(s))/rejection on loan application and approved loan size with justification provided.	Specify revised principles for justification of approval on application which are violating credit risk policies or general lending criteria.
Module (M) Submodules (S)	**Content**			
M2S1 Financial Analysis	-Accounting concepts -Financial ratios -Limitation of financial statements -Business drivers			
M2S2 Financial Strength Assessment	-Critical analysis of fin. statements • Internal factors • External factors • Business model -Cash budget analysis and fin. strength			
M2S3 Credit Risk Assessment and Structure Credit Facility	-Budget and pro-forma analysis -Quantitative analysis and risk assessment -Structure credit facilities	X	X	X

Module 2 - Mapping of Submodules with UoC Performance Requirements

109260L5 **Assess credit and financial strength of borrowers and prepare credit proposal** Conducting risk assessment on credit application. This applies to risk assessment using in-depth analysis on individual applications which usually cover loans involving significant amount such as project finance, corporate finance, aircraft financing, and general enterprise banking loan products, etc. Level: 5 Credit: 4		**UoC Performance Requirements**									
		Knowledge			**Application**						
Module (M) Submodules (S)	**Content**	Familiarize with special knowledge related to corporate finance in order to assess the risks of loan application.	Have in-depth understanding of credit management in order to identify factors which might affect default risks and assess the impact on loan applications.	Understand liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations.	Interprets research findings on macroeconomic environment and industry analysis in order to understand the business outlook of the applicants' businesses.	Interpret financial statements to determine financial standing of borrower.	Apply suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of businesses or projects.	Conduct site visit to verify the authenticity of documentation submitted and obtain additional information for assessment.	Conduct preliminary credit risk assessment by evaluating the business risk, financial risk and total corporate risk of the businesses/projects in consideration.	Provide recommendations regarding the degree of risk involved in extending credit or lending money by consolidating information from different analyses e.g., track record, business performance, collateral valuation).	Calculate the cost of offering the loan e.g., funding costs, overhead expenses, administrative costs.
M2S1 Financial Analysis	-Accounting concepts -Financial ratios -Limitation of financial statements -Business drivers										
M2S2 Financial Strength Assessment	-Critical analysis of fin. statements • Internal factors • External factors • Business model -Cash budget analysis and fin. strength	X	X	X	X	X	X	X			
M2S3 Credit Risk Assessment and Structure Credit Facility	-Budget and pro-forma analysis -Quantitative analysis and risk assessment -Structure credit facilities								X	X	X

Module 2 - Mapping of Submodules with UoC Performance Requirements

109260L5 **Assess credit and financial strength of borrowers and prepare credit proposal** Conducting risk assessment on credit application. This applies to risk assessment using in-depth analysis on individual applications which usually cover loans involving significant amount such as project finance, corporate finance, aircraft financing, and general enterprise banking loan products, etc. Level: 5 Credit: 4		**UoC Performance Requirements**				
		Application			**Behaviours**	
		Calculate amount to be allocated to loan loss reserve and capital charges based on default probability, loss levels, etc.	Provide recommendations regarding the affordability to enterprise clients and propose long-term, mid-term and short-term financing solutions.	Compute clients' ability to repay loan, estimate time for debt repayment given amount of debt, interest rates, and available funds.	Recommend approval (with or without conditions(s))/rejection on loan application and approved loan size with justification provided.	Provide justification for approval on application violating credit risk policy or lending criteria.
Module (M) Submodules (S)	**Content**					
M2S1 Financial Analysis	-Accounting concepts -Financial ratios -Limitation of financial statements -Business drivers					
M2S2 Financial Strength Assessment	-Critical analysis of fin. statements • Internal factors • External factors • Business model -Cash budget analysis and fin. strength					
M2S3 Credit Risk Assessment and Structure Credit Facility	-Budget and pro-forma analysis -Quantitative analysis and risk assessment -Structure credit facilities	X	X	X	X	X

Module 2 - Mapping of Submodules with UoC Performance Requirements

109257L5 **Structure the credit facility** Preparing proposal on credit facility which specify the detailed terms and conditions for submission to the approving authority of the bank. This applies to loan application which requires individual and/or group assessment and involves significant amount such as corporate finance, lease-based/asset-based financing solutions, aircraft and ship financing, machinery and equipment financing, project finance and syndicated loan. Level: 5 Credit: 4		**UoC Performance Requirements**									
		Knowledge			**Application**						
		Comprehend the theories and concepts related to corporate credit management in order to assess the risks of loan application.	Demonstrate professional knowledge in corporate loan financing by applying it to evaluate factors affecting default risks and assess the impact on loan applications.	Possess knowledge in different enterprise banking loan products of the bank and apply it to evaluate and compare the features of them in order to judge the suitability of loan applicants.	Identify clients' purposes and objectives for the loan by evaluating relevant information.	Interpret and analyse financial information submitted (e.g., financial statements) to determine financial standing of applicants.	Conduct financial analysis on the business such as income growth, quality/ competence of management and market share to determine expected profitability of the business thus the repayment abilities of applicants.	Perform assessment on the specific projects or assets which require financing, analyse cash flow to be generated and valuation of assets in order to have a more accurate assessment on the risks involved.	Develop tailor-made financial package options for applicants and structure the terms and conditions (e.g., loan amount, repayment timeline, rates, etc.) based on earnings, repayment history, prospective risk level, etc.	Develop loan repayment plan (e.g., when how and provide supporting information to substantiate the plan (e.g., projected cash flow, projected revenue).	Develop proposals to specify financing options available to applicants and present the terms and explanation in a clear manner.
Module (M) Submodules (S)	**Content**										
M2S1 Financial Analysis	-Accounting concepts -Financial ratios -Limitation of financial statements -Business drivers										
M2S2 Financial Strength Assessment	-Critical analysis of fin. statements • Internal factors • External factors • Business model -Cash budget analysis and fin. strength										
M2S3 Credit Risk Assessment and Structure Credit Facility	-Budget and pro-forma analysis -Quantitative analysis and risk assessment -Structure credit facilities	X	X	X	X	X	X	X	X	X	X

Module 2 - Mapping of Submodules with UoC Performance Requirements

<table>
<tr><td colspan="2">109257L5
Structure the credit facility

Preparing proposal on credit facility which specify the detailed terms and conditions for submission to the approving authority of the bank. This applies to loan application which requires individual and/or group assessment and involves significant amount such as corporate finance, lease-based/asset-based financing solutions, aircraft and ship financing, machinery and equipment financing, project finance and syndicated loan.

Level: 5
Credit: 4</td><td colspan="2">UoC Performance Requirements
Behaviours</td></tr>
<tr><td>Module (M)
Submodules (S)</td><td>Content</td><td>Determine pricing of individual credits to ensure the returns are commensurate with the risk level.</td><td>Analyse the risks of repayment and select suitable collateral or guarantee to protect the bank in case of inability to pay.</td></tr>
<tr><td>M2S1
Financial Analysis</td><td>-Accounting concepts
-Financial ratios
-Limitation of financial statements
-Business drivers</td><td></td><td></td></tr>
<tr><td>M2S2
Financial Strength Assessment</td><td>-Critical analysis of fin. statements
• Internal factors
• External factors
• Business model
-Cash budget analysis and fin. strength</td><td></td><td></td></tr>
<tr><td>M2S3
Credit Risk Assessment and Structure Credit Facility</td><td>-Budget and pro-forma analysis
-Quantitative analysis and risk assessment
-Structure credit facilities</td><td>X</td><td>X</td></tr>
</table>

Module 3 - Mapping of Submodules with UoC Performance Requirements

109260L5
Assess credit and financial strength of borrowers and prepare credit proposal

Conducting risk assessment on credit application. This applies to risk assessment using in-depth analysis on individual applications which usually cover loans involving significant amount such as project finance, corporate finance, aircraft financing, and general enterprise banking loan products, etc.

Level: 5
Credit: 4

		UoC Performance Requirements									
		Knowledge			Application						
Module (M) Submodules (S)	**Content**	Familiarize with special knowledge related to corporate finance in order to assess the risks of loan application.	Have in-depth understanding of credit management in order to identify factors which might affect default risks and assess the impact on loan applications.	Understand liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations.	Interprets research findings on macroeconomic environment and industry analysis in order to understand the business outlook of the applicants' businesses.	Interpret financial statements to determine financial standing of borrower.	Apply suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of businesses or projects.	Conduct site visit to verify the authenticity of documentation submitted and obtain additional information for assessment.	Conduct preliminary credit risk assessment by evaluating the business risk, financial risk and total corporate risk of the businesses/projects in consideration.	Provide recommendations regarding the degree of risk involved in extending credit or lending money by consolidating information from different analyses e.g., track record, business performance, collateral valuation).	Calculate the cost of offering the loan e.g., funding costs, overhead expenses, administrative costs.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition										X
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge and skills -Consultation process -Presentation process -Negotiation process										

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

109260L5 **Assess credit and financial strength of borrowers and prepare credit proposal** Conducting risk assessment on credit application. This applies to risk assessment using in-depth analysis on individual applications which usually cover loans involving significant amount such as project finance, corporate finance, aircraft financing, and general enterprise banking loan products, etc. Level: 5 Credit: 4		**UoC Performance Requirements**				
		Application			**Behaviours**	
Module (M) Submodules(S)	**Content**	Calculate amount to be allocated to loan loss reserve and capital charges based on default probability, loss levels, etc.	Provide recommendations regarding the affordability to enterprise clients and propose long-term, mid-term and short-term financing solutions.	Compute clients' ability to repay loan, estimate time for debt repayment given amount of debt, interest rates, and available funds.	Recommend approval (with or without conditions(s))/rejection on loan application and approved loan size with justification provided.	Provide justification for approval on application violating credit risk policy or lending criteria.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition		X	X		
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process					

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

109257L5 **Structure the credit facility** **Preparing proposal on credit facility which specify the detailed terms and conditions for submission to the approving authority of the bank. This applies to loan application which requires individual and/or group assessment and involves significant amount such as corporate finance, lease-based/asset-based financing solutions, aircraft and ship financing, machinery and equipment financing, project finance and syndicated loans.** **Level: 5** **Credit: 4**		UoC Performance Requirement						
		Knowledge			**Application**			
Module (M) Submodules (S)	**Content**	Comprehend the theories and concepts related to corporate credit management in order to assess the risks of loan application.	Demonstrate professional knowledge in corporate loan financing by applying it to evaluate factors affecting default risks and assess the impact on loan applications.	Possess knowledge in different enterprise banking loan products of the bank and apply it to evaluate and compare the features of them in order to judge the suitability of loan applicants.	Identify clients' purposes and objectives for the loan by evaluating relevant information.	Interpret and analyse financial information submitted (e.g. financial statements) to determine financial standing of applicants.	Conduct financial analysis on the business such as income growth, quality/ competency of management and market share to determine expected profitability of the business thus the repayment abilities of applicants.	Perform assessment on the specific projects or assets which require financing, analyse cash flow to be generated and valuation of assets in order to have a more accurate assessment on the risks involved.
M3S1 Bank Products and Credit Facility Structure for Large and complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition			X				
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process							

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

109257L5 **Structure the credit facility** **Level: 5** **Credit: 4** **Preparing proposal on credit facility which specify the detailed terms and conditions for submission to the approving authority of the bank. This applies to loan application which requires individual and/or group assessment and involves significant amount such as corporate finance, lease-based/asset-based financing solutions, aircraft and ship financing, machinery and equipment financing, project finance and syndicated loans.**		UoC Performance Requirement				
		Application			**Behaviour**	
Module (M) Submodules(S)	**Content**	Develop tailor-made financial package options for applicants and structure the terms and conditions (e.g. loan amount, repayment timeline, rates, etc.) based on earnings, repayment history, prospective risk level, etc.	Develop loan repayment plan (e.g. when, how) and provide supporting information to substantiate the plan (e.g. projected cash flow, projected revenue).	Develop proposals to specify financing options available to applicants and present the terms and explanation in a clear manner.	Determine pricing of individual credits to ensure the returns are commensurate with the risk level.	Analyse the risks of repayment and select suitable collateral or guarantee to protect the bank in case of inability to repay.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition	X	X	X	X	
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process					

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

109293L5
Structure credit facilities for large scale operating assets financing programmes

Level: 5
Credit: 4

Structuring credit facilities on large scale operating assets financing programmes. This applies to the use of a client's company's balance sheet assets, including short-term investments, inventory and accounts receivable, to extend a large amount of mid to long term loan to large and complex corporate clients,

		UoC Performance Requirement							
		Knowledge			**Application**			**Behaviour**	
Module (M) Submodules (S)	**Content**	Demonstrate comprehensive and specialized knowledge in credit management in order to structure financing programmes on operating assets.	Possess professional knowledge regarding the industry specialization (e.g. sector structure, key competitors, critical success factors) of the clients in order to evaluate the risks and profitability of the deal.	Demonstrate professional knowledge in operating assets finance by applying it to assess the values of clients' operating assets and inventory to justify loan approval.	Evaluate the performance of clients' business by employing different qualitative and quantitative methods (e.g. accounting ratio, cash flow analysis).	Assess the risks of applications and evaluate the business strategies of the company in order to assess the needs in asset investment and the commercial value of the operating assets.	Analyse the capital structure of clients in order to identify the most suitable means of financing which can balance their assets and liabilities portfolio.	Structure the deals in accordance with the credit worthiness of the clients, values of the operating assets, projected performance of the business and credit strategies of the bank.	Analyse the debt structure of the clients to structure a deal which can meet the financial needs of clients while provide adequate protection to the bank's interests.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition	X	X	X		X	X	X	X
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process								

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

109258L5 **Evaluate the performance of credit acquisition and make suggestions** **Level: 5** **Credit: 4** **Evaluating revenue obtained from credit business and make suggestions on improving credit acquisition strategies. This applies to different kinds of credit products and services provided by the bank.**		**UoC Performance Requirement**										
		Knowledge		**Applications**					**Behaviour**			
Module (M) Submodules(S)	**Content**	Understand the technical knowhow of credit acquisition and apply the knowledge to evaluate the formula in calculating revenue to ensure the existing approach can provide an accurate and comprehensive calculation.	Understand the key factors which might affect the revenue from credit acquisition and apply the knowledge to execute a fair and unbiased evaluation on the performance of the bank's credit business.	Evaluate the performance of credit business and identify factors affecting the performance.	Estimate cost and revenue associated with different credit acquisition.	Compare the results with the performance in other time periods and conclude on the effectiveness and profitability of the credit business after considering the business and economic situations.	Analyse the hit rate on credit acquisition and calculate the success rate on different types of business (e.g. credit products, clients' segments).	Analyse failed cases in credit acquisition and conduct relevant analysis (e.g. competitor analysis) to identify the causes.	Evaluate different approaches for pricing and select the most optimal one after analysing the performance of credit business.	Conduct pricing comparison with other banks so as to recommend a competitive offer.	Determine the optimal levels of and standards for credit limits, risk cut-offs, collection actions to balance profitability and risk.	Develop alternatives to balance income potential with sufficient credit loss reserve levels.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition	X		X	X		X	X	X	X		
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process											

Remark: The competencies not mapped in the above table are mapped to Module 1

Module 3 - Mapping of Submodules with UoC Performance Requirements

109259L5
Provide consultancy service to clients on credit risks

Level: 5
Credit: 4

Provision of advisory services to clients on the credit risk of the products. This applies to enterprise clients of different segments and products of different types.

Module (M) Submodules(S)	Content	UoC Performance Requirement: Knowledge		UoC Performance Requirement: Application				UoC Performance Requirement: Behaviour	
		Understand different theories and concepts related to credit analysis in order to assess the suitability of loan products offered to different clients.	Possess professional knowledge in credit analysis and different credit products and apply it to provide suitable advice to enterprise banking clients.	Analyse risks associated with the products or services requested by the clients and assess the suitability.	Assess the knowledge of the clients in order to evaluate their understanding on the risks inherited in the products or services.	Identify customers' needs on consultancy service related to credit risk based on their business model, knowledge on the products acquired, etc.	Explain features and risk levels of different alternatives and use appropriate methods to ensure clients have an accurate understanding.	Provide customized consultancy service on credit risks in accordance with the financial situation and risk bearing ability of each enterprise client.	Evaluate the situation of clients and provide advice on the suitable alternatives on investment/ settlement methods in accordance with their unique financial situation and needs.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition								
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process					X	X	X	X

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

UoC 109503L5
Present financial solutions to general enterprise banking clients

Level: 5
Credit: 4

Delivering details of the solutions (e.g. product details, pricing, terms and conditions) to clients to obtain their engagement. This applies to different kinds of lending and services to general enterprise clients including but not limited to accounts receivable financing, invoice factoring, global trade financing and asset-based lending.

		UoC Performance Requirement								
		Knowledge		**Application**				**Behaviour**		
Module (M) Submodules (S)	**Content**	Demonstrate professional communication and presentation skills in order to communicate the proposal clearly.	Possess the product knowledge and knowledge on the client and be able to highlight key factors that can exert influence on client’ s decision in the presentation.	Match appropriate banking products with customer needs in order to offer the best solutions for clients and describe the details of the proposal (e.g. terms and conditions) in an accurate manner.	Evaluate the business negotiation continuously and make appropriate changes in sales approach in order to increase the odds of success.	Communicate risks to customers in accordance with sales compliance and check client’ s understanding of clients.	Manage the expectations of clients in order to preserve a long-term harmonious relationship with them.	Make enough preparation to forecast possible enquiries or objections from clients and get proper answers ready in advance.	Handle the inquiries from clients professionally to address technical issues in order to close the deals with client satisfaction.	Be client focused by paying attention to prospects’ buying signals and gain their commitment at appropriate time by using suitable closing techniques.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition		X	X						
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process	X			X	X	X	X	X	X

Module 3 - Mapping of Submodules with UoC Performance Requirements

109504L5
Negotiate with the clients to finalize the customized financial solutions

Level: 5
Credit: 4

Negotiating with clients to finalize all details included in the solutions as offered by the bank. This applied to large volume and complicated business in enterprise banking which requires customized solutions. It may sometimes involve originating, structuring, underwriting, executing, and syndicating a wide variety of capital-raising transactions across international capital markets.

		UoC Performance Requirement									
		Knowledge		**Application**				**Behaviour**			
Module (M) Submodules (S)	**Content**	Demonstrate professional knowledge in business negotiation by evaluating different negotiation strategies and theories in consumer psychology and applying them aptly according to the situations.	Demonstrate professional knowledge in corporate and commercial lending to assess the counter offers proposed by clients.	Assess the bottom line of prospects (i.e. must have, should have, nice to have) in order to propose a compromise solution.	Determine the bottom line of the bank and develop different concessions alternatives with an attempt to maximize the bank' s outcomes.	Evaluate the position of the bank and client by estimating the risks exposure faced by the bank and evaluating against its risk tolerance ability when restructuring the position.	Anticipate the potential concerns and objections of the prospects in order to develop possible counter-solutions to pre-empt their concerns.	Be client focused and identify the negotiation styles of prospects to adapt to their styles while planning the negotiation strategies.	Address actual client needs during negotiation and employ influencing and persuasive skills to provide compelling reasons to facilitate the decision-making process of clients.	Be well prepared in coordination with different technical specialists to restructure the proposal according to clients' needs, if necessary.	Determine when to withdraw from the negotiation if a feasible/profitable deal cannot be achieved and conduct the closure professionally and tactically.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition		X								
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process	X		X	X	X	X	X	X	X	X

Module 3 - Mapping of Submodules with UoC Performance Requirements

109502L5
Conduct company financial analysis to identify clients' needs

Level: 5
Credit: 4

Conducting different kinds of analyses to evaluate the company performance of banking facilities applicants as part of the account planning process. This involves reviewing of different financial reports of the clients and applies to different kinds of lending to small and medium sized enterprises.

		UoC Performance Requirement									
		Knowledge		Application					Behaviour		
Module (M) Submodules (S)	**Content**	Demonstrate in-depth knowledge on company financial analysis by applying it to evaluate different common methodologies within the bank's framework in analysing company performance and to develop a suitable approach for assessing the current banking facility application.	Demonstrate professional knowledge in the clients' industry, e.g. key terms and terminology, performance indicators for analysis, business cycle, competitive landscape, latest development, etc. in order to identify focus and scope of company analysis.	Identify information useful for understanding the businesses and employ different approaches to obtain the relevant information for account planning purpose (e.g. send request to clients, industry practitioners, etc.)	Consolidate relevant financial data and evaluate financial position of client by analysing financial statements, business contracts, ageing reports and, etc.	Analyse the strategic direction and major business initiatives to identify the future potential, challenges, and opportunities of the company.	Evaluate the business models and identify factors that may impose significant effects on their earnings and cost structures hence to predict the prospect of the business.	Assess the risk of potential financial loss that doing business with the client, ultimately determining whether to offer the credit facilities.	Identify key forces shaping the industry of the clients' businesses and learn from the accuracy of historical forecasts to make adjustments to the assessment methods.	Analyse the value chain of the business and adopt a holistic consideration to assess opportunities and risks associated with the client's operations.	Compare the performance, business model and operations of the clients with companies of similar size in the same industry hence to produce a fair judgement.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition										
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process					X	X			X	

Remark: The competencies not mapped in the above table are mapped to Module 2

Module 3 - Mapping of Submodules with UoC Performance Requirements

109269L5 **Evaluate market value and marketability of collateral and identify the risks associated with the loan** **Level: 5** **Credit: 4** **Evaluation of the market value of credit assets possessed by the bank in order to judge risks associated with the loans. This applies to credit assets of different kinds.**		**UoC Performance Requirement**							
		Knowledge		**Application**				**Behaviour**	
Module (M) Submodules (S)	**Content**	Demonstrate professional knowledge on the bank’ s policies about different types of well-defined acceptable collateral and their respective security value in accordance with internal guidelines.	Possess specialized skills on asset valuation and apply them to evaluate common practices in banking industry in order to refine existing approach adopted by the bank.	Identify factors which can affect the market value of different kinds of assets to ensure an accurate valuation.	Analyze market situations and valuation done by other banks in order to evaluate the formula of assets valuation adopted by the bank.	Analyse information on trends in historical price, future economic development and other relevant factors in order to determine the fair market value of different collaterals.	Evaluate changes in the value of collaterals and adjust risks associated with the loan accordingly.	Initiate the loan review process to evaluate whether adjustment is necessary.	Always benchmark and follow the best practices to execute asset valuation.
M3S1 Bank Products and Credit Facility Structure for Large and Complex Clients	-Bank products -Financial solutions customization -Credit facility structure -Collateral valuation and loan risk -Pricing and affordability -Evaluation of credit acquisition	X	X	X	X	X	X	X	X
M3S2 Consultation, Presentation, Negotiation and Code of Ethics	-Overview of code of ethics, behavioural knowledge, and skills -Consultation process -Presentation process -Negotiation process								

4 Level of Learning

The ECF-CRM is referenced to the QF, with the Core Level training programme (including Modules 1, 2, and 3) mapped at QF Level 5 (i.e. equivalent to bachelor's degree level). As banks have different business scopes and degrees of sophistication, Users may adjust the relevant teaching, learning, and assessment contents for any variations in learning objectives and target learners.

5 Volume of Learning

The following table indicates the NLH by learning mode for Modules 1, 2 and 3.

NLH	Self-Managed			Post-class	Total
		Class Including assessment			
	Self-study	Preparation of assessment case	Class including assessment		
Module 1	115	-	40	105	260
Module 2	66	-	21	63	150
Module 3	96	32 [6]	15	42	185

[6] Module 3 Submodule 2 contains simulation case assessment. To streamline class flow, the training package suggests the learners prepare the case in advance.

E. LEARNING AND TEACHING GUIDE

This section provides the ILO and suggests each submodule's teaching and learning outline (Sections E1, E2, and E3). In addition, Users may refer to the sample content notes in Section G Support Materials for Trainers to develop lecture notes/PPT for learners.

It also gives the suggested learning modes and methods (Section E4), the learning context (Section E5), format of teaching and learning resources suggested such as learning activities, proposed time allocation, and learning facilities (Section E6), to enable learners to achieve the ILO progressively by learning about performance expectations, credit guidelines, theories, practices, skills and attitudes.

It is recommended that the Trainer prioritize the training contents in terms of importance according to the context of the learners' working background and experience. For instance, updates to prioritization reflect bank users' input and practical applicability, regulatory, and competency standards. The prioritization grid below is a reference for high-prioritized content. The time allocation for the most important, less important, and remaining should be 50%, 30%, and 20%, respectively. It helps the learners prioritize their work during self-study and better allocate their study resources.

Training Content Prioritization Reference Grid for High Priority		
Update in Bank focus	Bank users' input and practicability e.g., Bank's credit risk management disclosures in annual reports, management's remarks on learner's working background and experience	High priority given to content that aligns with recent trends in the bank's reports.
Update in HKMA focus	HKMA's banking priorities: key areas of focus and strategy e.g., Hong Kong Banking Sector: 2023 Year-end Review and Priorities for 2024 (hkma.gov.hk)	High priority given to content based on latest key focus areas and strategy of the regulatory authority.
Update in HKMA guide	HKMA regulatory guides e.g., Hong Kong Monetary Authority - Credit Risk Management (hkma.gov.hk)	High priority given to content based on latest regulatory guideline.
Update in QFHK SCS	QF SCS corporate banking e.g.,Specification of Competency Standards for Corporate / Commercial Banking (hkqf.gov.hk)	High priority given to latest updates on Specification of competency standards
Update in trainer's observation	Trainer's observations e.g., summary of learner's remarks during classes	High priority be given to the learner's gaps identified through performance assessment and classroom interactions

All sections in the Training Package are relevant to Users who aim to develop Module 3 only. Users may refer to Sections E1 and E2 and Sections G1 and G2 for the prior knowledge, skills, and behaviours covered in Modules 1 and 2. The Training Package provides connecting links in Section E3 for efficiently locating Sections E1 and E2.

1 Module 1

1.1 Submodule 1: Early Warning Signal

1.1.1 ILO

Upon completion of learning, learners would be able to monitor loan accounts and portfolios daily to identify early warning signal.

<u>ILO</u>

Monitor portfolio – theory and practice
- Identify the most appropriate method in risk monitoring
- Understand the bank's credit strategies and portfolio objectives
- Identify early signals of delinquency or system risk
- Identify sources and causes of changes in risk level
- Apply impartial and unbiased judgement

Identify early warning signal
- Monitor and ensure credit administration in compliance
- Track risk indicators or credit quality and detect changes in risk characteristics

Identify the relationship of risk level change with loan provision
- Review approaches and adopt the most reasonable measures

Identify key regulations, report remedy, and make recommendations
- Report to senior management on results of analysis

1.1.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 1 - Submodule 1
Early Warning Signal</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Monitor portfolio – theory and practice</td></tr>
<tr><td>Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring.</td><td>Basics in CRM for identification of appropriate methods
- Importance of credit risk management in CAMEL Rating
- Credit risk
- Credit risk management system
- Credit risk management governance
- Credit risk management scale
- Credit process
- Credit risk management structure
- Constraints and challenges
- Technology solutions to overcome constraints and challenges
- Analytical approach on risk
- Credit default circumstances
- Theories/models for credit risk management
- Corporate finance theories relevant to credit risk management method</td></tr>
<tr><td>Understand the credit strategies and portfolio objectives of the bank in order to identify crucial areas for monitoring.</td><td>Basics in credit strategies for identifying crucial area of monitoring
- Elements of credit strategy
- Portfolio credit risk management objectives</td></tr>
<tr><td>Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt remedial actions.</td><td>Basics to identify signals for escalation
- Credit risk management process: identify, measure, monitor and control
- Signals at account level
- Signals at portfolio level
- Signals at macro-economic level
- Other essential signals</td></tr>
<tr><td>Identify the sources and causes of the changes in risk level, e.g., underwriting standards, economic conditions, personnel issue and recommend appropriate corrective actions.</td><td>Basics of sources and causes of changes for remedial actions
- Knowledge management of all inhouse, external and industry information
- Internal, external, and industrial factors</td></tr>
<tr><td>Demonstrate professionalism by applying impartial and unbiased judgment throughout the loan portfolio assessment process.</td><td>Exercising unbiased judgment
- Review and prioritize risk level of external, industrial and internal factors
- Review and prioritize contagious effects on portfolio performance</td></tr>
</table>

	- Assign independent party for risk monitoring
Identify early warning signal	
Monitor and ensure credit administration is compliance with contractual requirements and facility terms.	**Overview of Credit Administration Function** - Compliance with T&C - Operational review
Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios.	**Basics to detect changes of risk indicators** - Key drivers of credit risk (EAD, PD, LGD, Tenor): single debt and portfolio - Challenges to estimate credit risk - Suitable method to aggregate risk at portfolio level - Convention of risk rating - External credit rating agency service and precautionary measures - Limitation on use of credit rating agency's service and alternatives - Internal credit rating system – large borrowers - Internal credit rating system – small business borrowers - Benefits of multiple grades - Direct influence of internal credit rating on banks' actions - Benefit of assigning credit rating to borrowing accounts - Relationship between regulatory requirement and internal credit rating - Evaluation on impact of the changes in risk factors
Identify the relationship of the risk level change with loan provision	
Regularly review the advantages and weaknesses of forecasting and reviewing approaches and adopt the most reliable measure.	**Regular forecast and review requirements** - Refer to sources of guidelines for loan provisioning forecast • The HKMA guidance • Multiple risk rating • Loan provisioning & expected credit loss • Continual assessment of loan provisioning
Identify key regulations, report remedy, and make recommendations	
Report to senior management about the results of analysis on risk profile of overall loan portfolio.	**Risk profile analysis and reporting** - Standardized and IRB approach and justifications - Regulatory capital versus economic capital - Credit loss absorption - Senior Management's role in credit risk monitoring - Tools for senior management's credit risk oversight

1.2 Submodule 2: Risk Mitigation

1.2.1 ILO

Upon completion of learning, learners would be able to understand the mitigation strategies and apply to different kinds of credit assets in the portfolios.

ILO

Monitor portfolio – theory and practice

- Demonstrate knowledge in credit risk management
- Use different tools for risk mitigation
- Understand the impact of external factor changes
- Construct strategy to diversify concentration risk
- Formulate measures to protect against risk exposure
- Develop policies and procedures with risk mitigation techniques
- Manage the risk mitigation activities

Identify the needs for risk mitigants

- Conduct risk analysis to identify critical factors impacting the risk level

Identify the relationship of risk level change with loan provision

- Develop guidelines and standards when approaching or exceeding portfolio limits

Identify key regulations, report remedy, and make recommendations

- Evaluate credit strategy, risk exposure to construct a suitable approach
- Conduct regular review on result of mitigation instructions and give suggestions

1.2.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 1 - Submodule 2
Risk Mitigation</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Monitor portfolio – theory and practice</td></tr>
<tr><td>Demonstrate professional knowledge in credit risk management in order to maintain an optimal risk level for credit portfolio.</td><td>Optimal risk level
- Risk appetite
- Importance of defining risk appetite
- Process of setting risk appetite</td></tr>
<tr><td>Professional knowledge in credit management by utilizing different tools (e.g., setting exposure limits, credit derivative) in managing credit risk and their performance in different economic scenario.</td><td>Utilize risk management tools
- Ongoing monitoring framework
- Risk limits
- Risk profiling</td></tr>
<tr><td>Understand the impacts on business environment caused by the changing external factors and apply the knowledge to evaluate current and future economic outlook and regulatory development for the purpose of developing suitable strategies in risk mitigation.</td><td>Impacts of external factors
- Environment scanning
- Sources of intelligence</td></tr>
<tr><td>Construct strategies in diversifying concentration risk, e.g., reducing exposures to particular type of loan, broaden customer base, altering product mix, industry etc.</td><td>Diversify concentration risk
- Strategy of portfolio diversification
- Risk mitigant definition
- Risk mitigant types
- Risk mitigant strength</td></tr>
<tr><td>Formulate measures to protect the bank from undue risk exposure by employing suitable techniques, e.g., asset sales, securitization, credit derivatives, etc.</td><td>Formulate risk mitigation measures
- Risk mitigants provided by borrowers or third parties
- Risk mitigants proactively managed</td></tr>
<tr><td>Develop policies and procedures for applying different types of credit mitigation techniques.</td><td rowspan="2">Credit risk mitigation techniques at right timing
- Identification of needs for risk mitigants
- Strong credit risk culture is essential for identification of risk
- Implementation of risk limits with comprehensive credit policy
- Check and balance on the risk-return</td></tr>
<tr><td>Manage the activities of credit risk mitigation strategies to ensure they are applied at the right time and used for their purported purpose.</td></tr>
</table>

Identify needs for risk mitigants	
Conduct analysis on the trends on risk level of the credit portfolio in order to identify critical factors which can affect the risk level.	**Quantified risk level trends for critical factors** - Quantified risk appetite - Credit risk strategy alignment with credit risk objectives - Credit risk appetite statement translated into credit criteria on loan application and review - Alignment of portfolio performance indicators with risk appetite metric - Portfolio indicators for senior management's reference
Identify the relationship of risk level change with loan provision	
Develop guidelines and standards on reporting to management when the aggregate exposure is approaching or exceeding portfolio limits.	**Exposure approaching or exceeding limits** - Regular review of risk level change - Credit risk mitigation and loan provisioning - IFRS9 management implication in portfolio risk management
Identify key regulations, report remedy, and make recommendations	
Evaluate the credit strategies and existing risk exposure of the bank in order to construct a suitable risk management approach.	**Evaluate credit strategy for management approach** - Large exposure and concentration - Breach on large exposure exceeding regulatory limits
Conduct regular review on the results of the mitigation instructions and provide suggestions on necessary changes.	**Review mitigation results for suggestions** - Balance sheet exposures - Risk weighting

1.3 Submodule 3: Manage and Control the Risks

1.3.1 ILO

Upon completion of learning, learners would be able to manage risk of credit assets and develop risk control measures/remedy.

ILO

Monitor portfolio – theory and practice

- Demonstrate knowledge of evaluating different risk management strategy
- Understand banks' strategies and portfolio objectives
- Design measures to diversify risks into unrelated or less related business
- Manage credit risk with adequate tools
- Identify factors affecting the value of credit assets

Identify the relevant credit risk indicators – portfolio

- Identify the most suitable approach and develop the execution plan

Identify the relationship of risk level change with loan provision

- Evaluate the effectiveness of different approach and develop the execution

Identify the key regulations, report remedy, and make recommendation

- Provide suggestions on improvement

1.3.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

Module 1 - Submodule 3 Manage and Control the Risks	
UoC Performance Requirements (Exact stipulation in the UoC)	**Suggested Learning/Teaching**
Monitor portfolio – theory and practice	
Demonstrate professional knowledge in managing risk of credit assets by applying it to evaluate different risk management strategies for the purpose of designing a most suitable approach for the bank.	**Manage risk of credit assets** - Risk exposure - Concentration risk - Assuming concentration risk - Direct limit on concentration risk - Contagion risk from concentration - Concentration risk on collateral - Principles of controlling risk concentration
Understand the credit strategies and portfolio objectives of the bank in order to build an alignment between the selected risk management approach and the bank's strategies	**Align risk management strategies with banks' strategies on complex products and borrowers' structure** - Portfolio risk control - Quality credit risk policy - Keep abreast of regulatory requirement both locally and cross-border-wise
Design risk management measures to diversify risks into different uncorrelated or less correlated business.	**Measures to diversify risk** - Risk diversification approaches – simple versus statistical - Credit risk mitigation – traditional versus portfolio approach - Credit risk diversification has limitation
Mitigate credit risk by acquiring security, insurance, third party guarantee, etc.	**Mitigate credit risk** - Security and third-party guarantee - Insurance - Other risk management measures and their limitations • asset sales • asset securitization • credit derivatives - BIS principles on controlling residual risk and hedging maturity mismatch - Credit risk exit strategy - New product launch
Identify factors affecting the value of the credit assets for assessing the purchase or selling price in order to quantify the risks.	**Identify risk factors for quantification** - Acceptance criteria and factors affecting the value of the credit assets for purchasing and selling to quantify the risk - Portfolio control on guarantee

	- Portfolio control on collaterals and risk mitigation
Identify the relevant credit risk indicators	
Assess the situation in order to identify the most suitable approach in risk management and develop the execution plan.	**Assess the situation for developing execution plan** - Assessment of the situation to identify the most suitable approach in risk management and execution - Examples of indicators of the account risk profile - Examples of portfolio indicators computed with conventional methods and statistical tools
Identify the relationship of risk level change with loan provision	
Evaluate effectiveness of different approaches of risk management for the purpose of transferring or mitigating credit risk.	**Evaluate effectiveness of mitigation** - Impact of account risk changes to provisioning - Impact of portfolio risk changes to provisioning
Identify key regulations, report remedy, and make recommendations	
Review current risk management measures and provide suggestions on improvement based on results of evaluation on different approaches for transferring or mitigating credit risks.	**Provide suggestions on improvement** - Reporting prudential limits - Clustering limits - Current risk management review

1.4 Submodule 4: Stress Testing

1.4.1 ILO

Upon completion of learning, learners would be able to understand stress testing and analyse the results to identify vulnerable segments in portfolios.

<u>ILO</u>

Monitor portfolio – theory and practice

- Demonstrate specialized knowledge in stress testing for development of suitable approach
- Understand credit strategies and portfolio objectives of banks
- Understand current macroeconomic environment and trends to identify key factors
- Identify factors that impose effects on risk level of loan portfolio
- Design methodology, analysis framework and tools aligned with objectives of testing
- Develop testing plan and conduct the test by altering assumptions in variables

Identify vulnerable sectors in the portfolio

- Analyse existing performance/risk of the portfolio to determine stress testing objectives
- Analyse performance of assets and liabilities under hypothetical scenarios
- Analyse the results of stress testing and identify vulnerability of different segment of loans

Identify Key Regulations, report remedy, and make recommendations

- Consolidate stress testing results and develop measures
- Develop contingency plans for vulnerable segments

1.4.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

Module 1 - Submodule 4 **Stress Testing**	
UoC Performance Requirements (Exact stipulation in the UoC)	**Suggested Learning/Teaching**
Monitor portfolio – theory and practice	
Possess specialized knowledge in stress testing and apply it to evaluate different methods of execution in order to develop a suitable approach for the bank.	**Suitable approach to stress testing** - Enterprise collaboration - Normal conditions - Stressful conditions - Planning for stress testing - Limitations of stress testing
Understand the credit strategies and portfolio objectives of the bank and based on that evaluate the existing portfolio of credit assets.	**Evaluate existing portfolio** - Stress testing - Purpose - Functions • Proactive credit risk management - Outcomes • Remedial credit risk management - Stress testing design • Different scale and complexity • Stress events, risk models and potential challenges
Understand the Current macroeconomic environment and trends and consider these as key factors of stress testing.	**Key factors for stress testing** - Stress testing design • Macroeconomic and other factors, methodology, analysis framework
Identify factors (e.g., financial data, economic variables) that can impose effects on risk level of loan portfolio and develop financial models to quantify the sensitivity of loan performance to different scenarios.	**Quantify sensitivity of the portfolio with design methodology** - Testing plan and altering assumptions - Testing scenario from lessons learned
Design methodology, analysis framework and tools on stress testing which are aligned with the objectives of the testing.	
Develop testing plan and conduct the test by altering assumptions in different variables and record the effect on portfolio credit quality.	**Alter assumptions in different variables** - Stress testing programme • Scenario example (A) domestic economic downturn • Scenario example (B) decline in the real estate market

<table>
<tr><td></td><td>• Scenario example (C) decline in the value and market liquidity of financial collateral
• Scenario example (D) increases in classified loans and provisioning levels
• Scenario example (E) rating migration of counterparties
• Scenario example (F) default of major counterparties
• Scenario example (G) decline in the value of taxi licenses/gross operating income of taxi drivers
- Hypothetical scenarios
- Quality assurance
- Compliance</td></tr>
<tr><td colspan="2">Identify vulnerable sectors in the portfolios</td></tr>
<tr><td>Analyse existing performance/potential risks of the portfolio in order to determine the objectives for stress testing.</td><td rowspan="3">Analyse situations with scenarios to identify vulnerable sectors
- Analysis accounts and portfolios
- Insight from stress testing</td></tr>
<tr><td>Analyse the performance of different assets and liabilities under the various hypothetical scenarios.</td></tr>
<tr><td>Analyse the results of stress testing and identify the vulnerability of different segments of loan portfolio.</td></tr>
<tr><td colspan="2">Identify key regulations, report remedy, and make recommendations</td></tr>
<tr><td>Consolidate the results of stress testing into the risk management process and develop suitable measures.</td><td>Consolidate results to develop suitable measures
- IFRS9 provisioning implication on planning
- Mitigation of potential biases of IFRS9 provisioning</td></tr>
<tr><td>Develop contingency plans for vulnerable segments, e.g., strengthening the supervision process, imposing limits, devising existing strategies.</td><td>Develop contingency plan
- Following up on the portfolio risk mitigation</td></tr>
</table>

1.5 Submodule 5: Account Monitoring and Problem Loan

1.5.1 ILO

Upon completion of learning, learners would be able to monitor the risk changes in accounts and portfolios, recovery, and workout of problem loans.

<u>ILO</u>

Monitor portfolio – theory and practice

- Identify method in borrowing account risk monitoring
- Keep up to date clients' current performance and future development
- Analyse the customers to identify risk level
- Track any irregularities
- Evaluate repayment record to identify possible causes of delay in payment
- Review accuracy of past document
- Identify deviation from agreed principles
- Analyse changes in client's financial situation
- Understand causes of problem loans
- Perform on-site inspection and regular due diligence
- Identify causes and sources of risk, report for prompt remedial actions
- Understand Theories and knowledge in banking lending

Identify delinquent payment's root causes

- Monitor and evaluate performance of clients' accounts
- Monitor indicators of credit quality
- Re-assess relationship and follow-up promptly

Identify the relationship of risk level change with loan provision

- Monitor borrowing accounts and advise customers of new or alternative services
- Determine amount of provision for problem accounts

Identify key regulations, report remedy, and make recommendations

- Restructure debts to improve clients' financial stability and solvency
- Classify the unpaid debt customers to make claims

1.5.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 1 - Submodule 5
Account Monitoring and Problem Loan Review</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Monitor portfolio – theory and practice</td></tr>
<tr><td>Demonstrate proficient knowledge in risk management in order to identify the most appropriate method in borrowing account risk monitoring.</td><td>Knowledge in borrowing account monitoring
- Objective of account monitoring
- Responsibility of account monitoring
- Functional units to perform account monitoring
- Following up problem loan</td></tr>
<tr><td>Keep up to date on the future development and current performance of clients’ business/ participating industry.

Analyse client’s historic information, account profile, account activities/pattern, business outlook, predicted future activity, financial and business data, etc. for identifying risk level.</td><td rowspan="5">Keeping up to date industry performance
- Account quality monitoring
• Pillars of quality
Reviewing, analyzing, comparing for tracking irregularities to identify risk level and root causes
- Document review
• Absolute compliance
• Throughout loan term
o Document update
o Document review to identify risk factors for risk mitigation/remedy
- Consolidate information to analyse changes</td></tr>
<tr><td>Analyse the customers, products activity and financial transactions profile of bank clients to track if any irregularities occur.</td></tr>
<tr><td>Evaluate the repayment record and transaction records of different accounts of the clients in order to identify possible causes for delay in payment.</td></tr>
<tr><td>Review the accuracy of past documentation (e.g., collateral valuable report, risk assessment, tracking report) and timeliness of problem identification in order to identify possible root causes for problem loans.</td></tr>
<tr><td>Compare the loan with lending guidelines to identify any deviation from the agreed principles.</td></tr>
<tr><td>Consolidate information from different sources in order to analyse the changes in financial</td><td></td></tr>
</table>

situations of the clients when compared to the time of loan origination	
Demonstrate professional knowledge in problem loans management (e.g., causes for problem loans, early warning signals) by applying it to identify the root causes of different problem loans. Perform on-site inspection and regular due diligence review to identify early signals or delinquency. Identify causes and sources of risks and report to appropriate parties for prompt remedial actions.	**Identifying early signs of delinquency for problem loan management and prompt remedial actions** - Early delinquency signals - Causes of delay in payment
Understand theories and knowledge in bank lending in order to analyse the situation in different cases of problem loans.	**Theories and knowledge of lending** - Comprehensive external factor reviews to arrive at recommended account actions - Management attention - Problem loan impact - Principles of problem loan management and examples of some best practices
Identify delinquent payment's root causes	
Understand the process of credit monitoring and evaluate the performance of client's accounts to compare with the credit strategies and portfolio objectives of the bank to identify critical areas for further follow-up actions. Monitor indicators of credit quality (e.g., delinquency, risk rating trends) and identify changes in risk characteristics of loan portfolio.	**Identifying critical area and changes for follow up** - Information generated from credit indicators - Principle of portfolio credit risk management and monitoring - Portfolio level credit indicators
Evaluate information related to current and projected financial status of applicants, hence, to re-assess the bank/client relationship and carry-on necessary follow-up actions promptly.	**Evaluating current and projected financial status** - The migration of individual credits through various grades with automatic/judgmental credit rating system
Identify the relationship of risk level change with loan provision	

Monitor clients' borrowing accounts and advise them of new or alternative services to meet their changing needs.	**Monitoring accounts for advising alternative services**
	- Loan provisioning purpose
	- Motivation for improvement
	- Loan provisioning
	  • General and specific
	  • By loan and portfolio basis

	• Per loan classification
Determine the amount of provision for problem accounts and assess the impact on the bank's credit portfolio.	**Determining provision amount** - Quality of loan provisioning and credit operations accuracy
Identify key regulations, report remedy, and make recommendations	
Be able to restructure debts of clients to improve clients' financial stability and solvency, when it is necessary.	**Debt restructuring** - Credit risk management process in compliance with operational risk management - IFRS9 management application in pricing and product design
Classify the unpaid debt customers to make claims and provide necessary information to relevant parties, if warranted.	**Classifying unpaid debt customers for making claims** - Judgment on loan classification

2 Module 2

2.1 Submodule 1: Financial Analysis

2.1.1 ILO

Upon completion of learning, learners would be able to apply financial and non-financial analysis to assess clients' financial positions, needs and credit worthiness.

<u>ILO</u>

Accounting Concept

- Demonstrate knowledge on company financial analysis to develop a suitable approach for assessing application

Financial Ratios

- Demonstrate knowledge in the client industry for analysis to identify focus and scope of company analysis

Financial Ratios

- Identify information useful for understanding the business and employ approaches to obtain relevant information for account planning

Key Business Drivers

- Analyse financial statements and relevant documents
- Identify future potential challenges and opportunities of the companies
- Identify factors that have effects on company earning and cost structures
- Assess the risk of potential financial loss of doing business with client
- Identify key forces shaping the industry of clients' business
- Analyse value chain of the business and adopt a holistic consideration
- Compare performance, business model and operations of clients with companies of similar size in the same industry to produce a fair judgement

2.1.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 2 – Submodule 1
Financial Analysis to Identify Customer’s Needs</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Accounting concepts</td></tr>
<tr><td>Demonstrate in-depth knowledge on company financial analysis by applying it to evaluate different common methodologies within the bank’s framework in analyzing company performance and to develop a suitable approach for assessing the current banking facility application.</td><td>- Accounting is a science
- Dual transactions basics
- Values of financial statements
- Financial statements tailored for stakeholders
- Quality of financial statements
- Financial accounting standards
- Accounting standards for listed companies in Hong Kong
- Accounting policy
- Information to look for in financial statements
- Relation between income statement and balance sheet
- Investigative approach of credit risk management: Financial statement analysis and examples of questionable transactions
- Sample of financial statements</td></tr>
<tr><td colspan="2">Financial ratios</td></tr>
<tr><td>Demonstrate professional knowledge in the client’s industry, e.g., key terms and terminology, performance indicators for analysis, business cycle, competitive landscape, latest development, etc. in order to identify focus and scope of company analysis.</td><td>- Sample financial statements to retrieve financial ratios for analysis, e.g.,
• Current ratio
• Quick ratio
• Gross profit ratio
• Operating profit
• Net profit margin
• Inventory turnover
• Receivable days
• Payable turnover
• Return on equity
• Return on assets
• Debt equity ratio
- Steps to prepare for financial analysis
- Bank product types affects the selection of critical financial ratios</td></tr>
</table>

Limitation of financial statements	
Identify information useful for understanding the business and employ different approaches to obtain the relevant information for account planning purpose (e.g., send request to clients, industry practitioners, and etc.).	- Scenarios on initial overall impression of the financial statements - Limitation of financial statements - Consequence of ignoring the limitations
Key business drivers	
Consolidate relevant financial data and evaluate financial position of client by analyzing financial statements, business contracts, ageing reports, etc.	Steps to identify and ascertain business drivers - Key business drivers - Analyzing strategic direction - Expression of the business model - Evaluation of the business model - Assessing risk of potential financial loss on doing business with the borrower - Identifying the key forces shaping the industry of the client's business - Analyzing value chain of the business to adopt a holistic consideration to assess risk and opportunities
Analyse the strategic direction and major business initiatives to identify the future potential, challenges and opportunities of the company.	
Evaluate the business models and identify factors that may impose significant effect on their earnings and cost structures hence to predict the prospect of the business.	
Assess the risk of potential financial loss that doing business with the client, ultimately determining whether to offer the credit facilities.	
Identify key forces shaping the industry of the clients' businesses and learn from the accuracy of historical forecasts to make adjustments to the assessment methods.	
Analyse the value chain of the business and adopt a holistic consideration to assess opportunities and risks associated with the client's operations.	
Compare performance, business model and operations of the clients with companies of similar size in the same industry hence to produce a fair judgement.	

2.2 Submodule 2: Financial Strength Assessment

2.2.1 ILO

Upon completion of learning, learners would be able to analyse clients' operational, financial, business, and internal factors to assess its financial strength and review clients' credit rating

ILO

Critical Analysis of Financial Statements (Internal Factors)
- Understand different credit products
- Identify factors affecting default risks and assess the impact on loan applications
- Understand corporate finance theories and concepts
- Understand special knowledge in corporate finance
- Evaluate and compare liquidity, profitability, and credit histories of companies
- Identify discrepancies or suspicious statements/reports
- Analysis comprehensively of financial standing of the borrower
- Conduct site visit to verify authenticity of documentation

Critical Analysis of Financial Statements (External Factors)
- Research on factors affecting default risks and assess the probability and impacts of default
- Interpret research findings on macroeconomic environment and industry
- Understand the business outlook of the applicants' business

Critical Analysis of Financial Statements (Business Models)
- Interpret financial statements to determine the financial standing of borrowers

Cash Analysis and Financial Strength
- Apply suitable methods to calculate the value of businesses or projects

2.2.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 2 – Submodule 2
Financial Strength Assessment</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Critical Analysis of Financial Statements (Internal Factors)</td></tr>
<tr><td>Understand the characteristics of different credit products offered by the bank and apply the knowledge to compare and contrast features of them in order to judge the suitability of loan applicants.</td><td>- Knowing bank products
- Examples of bank products
- Loans with competitors</td></tr>
<tr><td>Have in-depth understanding of credit management in order to identify factors which might affect default risks and assess the impact on loan applications.</td><td>Examples:
- Prudent procedures for approving credit
- Credit approval, review and records</td></tr>
<tr><td>Demonstrate expert knowledge in theories and concepts across different areas of corporate finance in order to assess the risks of loan application.</td><td rowspan="2">- Generally accepted accounting principles
- Corporate theories
- Corporate finance theories
- Examples of applications of corporate finance theories in credit risk management
- Cases</td></tr>
<tr><td>Familiarize with special knowledge related to corporate finance in order to assess the risks of loan application.</td></tr>
<tr><td>Understand liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations.</td><td rowspan="2">Critical analysis on
- Financial ratios
- Financial ratios deviated from industry norms
- Authentication of documents
- The borrower's cash flows and credit repayments
- The borrower's operational risk
- The borrower's financial leveraging
- Implications from cash flow analysis
- Default scenarios other than cash flow issues
- Constraints on cash flow analysis</td></tr>
<tr><td>Evaluate liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations in order to identify discrepancies or suspicious statements/reports.</td></tr>
<tr><td>Evaluate financial statements and identify incomplete information in order to have an accurate and comprehensive analysis on the financial standing of borrower (need for securities).</td><td>- Knowledge on industry cycles
- Values of site visits
- Checklist for site visits
- Powerful site visits to authenticate documents</td></tr>
<tr><td>Conduct site visit to verify the authenticity of documentation submitted and obtain additional information for assessment</td><td></td></tr>
</table>

Critical Analysis of Financial Statements (External Factors)	
Possess knowledge on the bank's business portfolio and conduct research on factors affecting default risks and assess the probability and impacts of default.	- External risk factors - Articulation of external risk factors - Interpreting research findings
Interpret research findings or other information on macroeconomic environment and industry analysis in order to assess business outlook and possible risks of the applicants' business.	
Interprets research findings on macroeconomic environment and industry analysis in order to understand the business outlook of the applicants' businesses.	
Critical Analysis of Financial Statements (Business Model)	
Interpret financial statements to determine financial standing of borrower.	- Limitation on financial statement analysis - Analysis of business models to supplement Financial Analysis
Apply suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of businesses or projects.	- Quantitative analysis to supplement business model analysis

2.3 Submodule 3: Credit Risk Assessment and Structure Credit Facility

2.3.1 ILO – before integration

Upon completion of learning, learners would be able to perform quantitative analysis about repayment capability, calculate potential losses, estimate risk-return, propose credit structure for eligible client.

ILO

Budget and Pro-Forma Analysis

- Calculate the value of the business or projects
- Compute the client's ability to repay a loan
- Determine the financial standing of applicants
- Determine the expected profitability of the company hence repayment ability
- Assessment of specific projects or assets for more accurate risk assessment

Quantitative Analysis and Risk Assessment

- Evaluate business risk, financial risk, and total corporate risk
- Conduct preliminary credit risk assessment
- Calculate the cost of offering the loan
- Calculate the amount allocated to loan loss reserve and capital charges
- Recommend regarding affordability of the client and solutions
- Determine pricing to ensure the returns are commensurate with the risk level
- Select suitable collateral or guarantee

Corporate Finance Knowledge and Structure Credit Facility

- Comprehend theories and concepts related to Credit Risk Management
- Evaluate factors affecting default risk
- Knowledge of different enterprise banking loan products and judging suitability of loan applicants
- Estimate the degree of risk involved
- Provide recommendations with consolidation of information from various analysis
- Make recommendation on approval (conditional approval)/rejection of application
- Recommend if assessment methods satisfy the changing lending criteria
- Recommend revised assessment criteria and approaches for determination of approval
- Specify revised principles for justification of support on applications which are violating credit risk policies
- Identify the client's purpose and objectives
- Develop a loan repayment plan
- Develop proposals to specify financing options and present terms and explanations in clear manner
- Develop a tailor-made financial package option

2.3.2 Content

The training programme designers may refer to the list below for the design of the learning and teaching programme:

<table>
<tr><th colspan="2">Module 2 – Submodule 3
Credit Risk Assessment and Structure Credit Facility</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Budget and Pro-Forma Analysis</td></tr>
<tr><td>Evaluate and select the most suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of the businesses or projects.</td><td rowspan="4">- Basic cash budget analysis
• Analysis to help clients to identify clients’ purpose and objectives for loan demands
• Suitable method for budget and pro-forma analysis
• Monitoring of cash generation/preservation capability
• Cash budget and SMEs
• Purpose of a cash budget
• Sample format of a cash budget
• Non-cash items
• Preparing cash budget
- Advanced budget and pro-forma analysis
• Preparing advanced budget and pro-forma analysis
• Quality budget and pro-forma analysis for key stakeholders
- Limitation with pro-forma financial statement analysis</td></tr>
<tr><td>Compute clients’ ability to repay loan, estimate time for debt repayment given amount of debt, interest rates, and available funds.</td></tr>
<tr><td>Interpret and analyse financial information submitted (e.g., financial statements) to determine financial standing of applicants.</td></tr>
<tr><td>Conduct financial analysis on the business such as income growth, quality competence of management and market share to determine expected profitability of the business thus the repayment abilities of applicants.</td></tr>
<tr><td>Perform assessment on the specific projects or assets which require financing, analyse cash flow to be generated and valuation of assets in order to have a more accurate assessment on the risks involved.</td><td>- Verifying the quality of cash flow
- Estimating cash flow gaps without the loan
- Quantifying the time uncertainty of repayments
- Estimating the achievability of the cash flow drivers</td></tr>
<tr><td colspan="2">Quantitative Analysis and Risk Assessment</td></tr>
</table>

Conduct credit risk assessment by evaluating the business risk, financial risk and total corporate risk of the businesses/projects in consideration.	- Risk assessment on qualitative risk factors and quantifiable risk factors
Conduct preliminary credit risk assessment by evaluating the business risk, financial risk and total corporate risk of the businesses/projects in consideration.	
Calculate the cost of offering the loan e.g., funding costs, overhead expenses, administrative cost.	- Cost factors of loan offering
Calculate amount to be allocated to loan loss reserve and capital charges based on default probability, loss levels etc.	- Loan loss reserve and capital charge allocation
Provide recommendations regarding the affordability to enterprise clients and propose long-term, mid-term and short-term financing solutions.	- Clients' affordability – factors for consideration
Determine pricing of individual credits to ensure the returns are commensurate with the risk level.	- Credit risk expressed in figures - Internal credit risk rating reflects credit risk
Analyse the risks of repayment and select suitable collateral or guarantee to protect the bank in case of inability to pay.	
Structure Credit Facilities	
Comprehend the theories and concepts related to corporate credit management in order to assess the risks of loan application.	- Cash flow projection - Present values - Net present values - Capital asset pricing model.
Demonstrate professional knowledge in corporate loan financing by applying it to evaluate factors affecting default risks and assess the impact on loan applications.	- Project finance and syndicated loan applicable to various industry such as: • shipping industry • petroleum and oil refinery industry • other industries which demand substantial loan amount and long pay-back period.
Possess knowledge in different enterprise banking loan products of the bank and apply it to evaluate and compare the features of them in order to judge the suitability of loan applicants.	
Estimate the degree of risk involved in extending credit or lending money by consolidating information from different analyses e.g., track record, business performance, collateral valuation).	- Analytical framework to recommend whether current assessment methods satisfy the changing lending criteria of the banks.

<table>
<tr><td>Provide recommendations regarding the degree of risk involved in extending credit or lending money by consolidating information from different analyses e.g., track record, business performance, collateral valuation).</td><td rowspan="2">Step (1) assess the specific risk of the borrower
Step (2) analyse and interpret the outcomes of critical financial analysis
Step (3) evaluate credit risks
Step (4) estimate the degree of risk involved in the loan (base case, stress case, default case)
- Estimating the degree of risk involved in base, stress and default scenarios</td></tr>
<tr><td>Recommend approval (with or without conditions(s))/rejection on loan application and approved loan size with justification provided.</td></tr>
<tr><td>Recommendations on whether the current assessment methods satisfy the changing lending criteria of the banks.</td><td rowspan="4">- Regular situation to structure credit proposal with sound credit granting process.
- Sample credit structure proposal with T&C suggestions for approval
- Credit structure with current assessment methods under changing lending criteria.
- Credit structure with recommended revised assessment criteria and approaches for determination of approval
- Justification for approval on application violating credit risk policy or lending criteria</td></tr>
<tr><td>Recommend revised assessment criteria and approaches for determination of approval (with or without condition(s))/rejection on loan application and approved loan size with justification provided.</td></tr>
<tr><td>Specify revised principles for justification of approval on application which are violating credit risk policies or general lending criteria</td></tr>
<tr><td>Provide justification for approval on application violating credit risk policy or lending criteria</td></tr>
<tr><td>Identify the client’s purpose and objectives for the loan by evaluating relevant information.</td><td rowspan="4"><u>Examples</u>
- Justification for approval on application violating credit risk policy or lending criteria</td></tr>
<tr><td>Develop loan repayment plan and provide supporting information to substantiate the plan.</td></tr>
<tr><td>Develop proposals to specify financing options available to applicants and present the terms and explanation in a clear manner.</td></tr>
<tr><td>Develop tailor-made financial package options for applicants and structure the T&C (e.g., loan amount, repayment timeline, rates, etc.) based on earnings, repayment history, prospective risk level, etc.</td></tr>
</table>

3 Module 3

3.1 Submodule 1: Credit Facility Structure of Bank Products for Large and Complex Clients

3.1.1 ILO

Upon completion of learning, learners will understand and prepare comprehensive significant credit facility proposals for large and complex clients with or without cross-border risk, and inter- and intra-company transactions, encompassing a variety of bank products and services such as those utilizing balance sheet assets.

<u>ILO</u>

Bank Products

- Understand the basics in bank products for general and large enterprise
- Have an overview of the products' unique features affecting product-client suitability

Financial solutions customization with view of adequate protection of bank's interest

- Understand the bank's credit strategies to protect bank's interest
- Evaluate the credit worthiness of sponsors of structured finance
- Assess the risk of the applications
- Assess the aligned needs of assets and debt-equity structure
- Identify the financing means for structuring deals

Credit facility Structure

- Customize the financial package option
    - Generic terms and conditions and proposal
    - Specialized terms (per scales, economic sectors, industries, maturities)

Collateral valuation and relevant associated loan risk

- Understand the policy and internal guideline
- Understand the methods of asset valuation
- Evaluate the common practices, benchmarking best practices to refine existing valuation approach
- Evaluate the factors affecting determination of accurate market values of assets/collaterals
- Maintain the management information and analytics
- Initiate, execute and review changes in collateral value
- Adjust the risk associated with loan and evaluate adjustment necessity
- Seek remedy and mitigation upon default event

Pricing and Affordability

- Determine price with different credit acquisition
  - Understand the regulatory impact on calculation of regulatory and commercial components of internal fund transfer pricing
  - Understand pricing approaches
  - Understand and evaluate pricing and cost formula
  - Determine, evaluate, select and recommend competitive offer
- Determine affordability
  - Recommend on clients' affordability
  - Facilitate clients to improve repayment ability and time to repay upon origination

Evaluation of Credit Acquisition

  - Track and analyse the hit rate
  - Track and analyse the failed cases

3.1.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 3 – Submodule 1
Credit Facility Structure of Bank Products</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Bank Products</td></tr>
<tr><td>Possess knowledge in different enterprise banking loan products of the bank and apply it to evaluate and compare the features of them in order to judge the suitability of loan applicants</td><td>Basics in bank products for identification of product-loan applicants’ suitability
- Bank product features and the participating entities (e.g. SPV) for general and large enterprise
• Overview
• Large scale and consortium-based lending
e.g., Syndicated loan
• Project and specialized financing
e.g., Project financing
e.g., Exploration & Production financing
• Asset-specific lending
e.g., Asset-based financing
e.g., Lease-based financing
• Trade and working capital-based lending
- Overview of the products’ unique features affecting product-client suitability</td></tr>
<tr><td colspan="2">Financial Solution Customization with view of adequate protection of bank’s interest</td></tr>
<tr><td>Assess the risks of applications and evaluate the business strategies of the company in order to assess the needs in asset investment and the commercial value of the operating assets</td><td rowspan="2">Basics in evaluations for financial solutions customization
- Understanding Bank’s credit strategies to protect bank’s interest
- Evaluating credit worthiness of sponsors of structured finance
- Assessing risks of applications
• Evaluating risk factors affecting tailoring of terms and conditions
○ Business strategies
○ Business earnings
○ Repayment history
○ Business outlooks</td></tr>
<tr><td>Analyse the capital structure of clients in order to identify the most suitable means of financing which can balance their assets and liabilities portfolio</td></tr>
</table>

Analyse the debt structure of the clients to structure a deal which can meet the financial needs of clients while provide adequate protection to the bank's interests.	○ Projected business performance (earnings and others) - Assessing aligned needs of assets and debt-equity structure • Needs in asset investment and operating asset values • Adequacy in debt/equity structure - Identifying financing means for structuring deals • Analyse and balance client's asset-liability portfolio
Credit Facility Structure	
Structure the deals in accordance with the credit worthiness of the clients, values of the operating assets, projected performance of the business and credit strategies of the bank.	**Basics in customized structure of a deal to support the development of credit proposal:** - Customizing financial package options Terms and conditions for agreement and developing proposal • Generic • terms and conditions e.g., loan type e.g., loan maturity and amount e.g., interest and fees e.g., repayment structure e.g., security and collaterals e.g., cross-border exposure e.g., intercompany debts e.g., positive and negative covenants per - risk of business strategy - risk of business model - risk of value chain - risk of further borrowing e.g., default and remedies e.g., jurisdiction e.g., others • proposals e.g., financing options e.g., substantiated plan with supporting
Develop tailor-made financial package options for applicants and structure the terms and conditions (e.g. loan amount, repayment timeline, rates, etc.) based on earnings, repayment history, prospective risk level, etc.	
Develop loan repayment plan (e.g. when, how) and provide supporting information to substantiate the plan (e.g. projected cash flow, projected revenue).	
Develop proposals to specify financing options available to applicants and present the terms and explanation in a clear manner.	
Demonstrate comprehensive and specialized knowledge in credit management in order to structure financing programmes on operating assets	**Specialized knowledge for structuring financing solutions** • Specialized credit facility per scales, economic sectors, industries, maturities

Possess professional knowledge regarding the industry specialization (e.g. sector structure, key competitors, critical success factors) of the clients in order to evaluate the risks and profitability of the deal.	○ Bank client scales e.g. General enterprise e.g. Large and complex corporate with or without intra-group/inter-group credit facilities ○ Economic sectors e.g. primary sectors e.g. secondary sectors e.g. tertiary sectors ○ Industries e.g. sector structure e.g. key competitors e.g. key success features ○ Terms of maturities/time horizon e.g. Short term loan e.g. Mid to long term loan
Demonstrate professional knowledge in operating assets finance by applying it to assess the values of clients' operating assets and inventory to justify loan approval.	
Collateral Valuation and Relevant Associated Loan Risk	
Demonstrate professional knowledge on the bank's policies about different types of well-defined acceptable collateral and their respective security value in accordance with internal guidelines.	**Basics in asset valuation for evaluation of the bank's existing approach** - Understanding policy, internal guideline (including collaterals with material positive correlation with the borrower's credit quality) • Acceptance criteria of collateral • Safe custody and access controls • Insurance • Loan-to-value ratio • Concentration limits • Frequency of revaluation and validity of collaterals - Understanding methods of asset valuation • Third party valuation • Inhouse valuation • Stress testing scenarios - Evaluating common practices, benchmarking best practices to refine existing valuation approach
Possess specialized skills on asset valuation and apply them to evaluate common practices in banking industry in order to refine existing approach adopted by the bank	
Identify factors which can affect the market value of different kinds of assets to ensure an accurate valuation.	**Maintaining management information and analytics to adjust relevant associated loan risk** - Management Information and analytics • Factors affecting determination of accurate market values of assets/ collaterals ○ Market situation
Analyse market situations and valuation done by other banks in order to evaluate the formula of assets valuation adopted by the bank.	

<table>
<tr><td>Analyse information on trends in historical price, future economic development and other relevant factors in order to determine the fair market value of different collaterals.</td><td rowspan="4">o Historical price trends
o Future economic development
o Valuation done by other banks
- Maintaining management information and analytics
- Initiating, executing and reviewing changes in collateral value
o Inherent risk
e.g., maturity mismatch
e.g., currency mismatch
o Determining fair market value
o Adjusting fair market value
o Evaluating asset valuation formula
- Adjusting risk associated with loan and evaluate adjustment necessity
- Seeking remedy and mitigation upon default event
• Controversy over collaterals upon default event
• Collateral allocation mechanism
• Remedies
e.g., recission
e.g., waterfalls
e.g., set off
e.g., top up collaterals</td></tr>
<tr><td>Evaluate changes in the value of collaterals and adjust risks associated with the loan accordingly.</td></tr>
<tr><td>Initiate the loan review process to evaluate whether adjustment is necessary.</td></tr>
<tr><td>Always benchmark and follow the best practices to execute asset valuation</td></tr>
<tr><td colspan="2">Pricing and Affordability</td></tr>
<tr><td colspan="2">- Pricing with different acquisition</td></tr>
<tr><td>Understand the technical KNOW-HOW OF CREDIT ACQUISITION and apply the knowledge to evaluate the formula in calculating revenue to ensure the existing approach can provide an accurate and comprehensive calculation.</td><td rowspan="4">Basics in revenue and cost of credits for determining that pricing commensurate risk
• Understanding regulatory impact on calculation of regulatory and commercial components of internal fund transfer pricing
• Understanding pricing of different loan acquisitions
e.g., All-in
e.g., Credit rating
e.g., Product and service type
• Understanding pricing approaches
• Understanding and evaluating pricing and cost formula
e.g., Internal fund transfer pricing
e.g., Overhead and administration</td></tr>
<tr><td>Determine pricing of individual credits to ensure the returns are commensurate with the risk level.</td></tr>
<tr><td>Evaluate different approaches for pricing and select the most optimal one after analysing the performance of credit business.</td></tr>
<tr><td>Conduct pricing comparison with other banks so as to recommend a competitive offer.</td></tr>
</table>

Calculate the cost of offering the loan e.g., funding costs, overhead expenses, administrative costs Estimate cost and revenue associated with different credit acquisition.	• Determining, evaluating, selecting and recommending competitive offer e.g., Selecting optimal approach e.g., Conducting competitive pricing e.g., Evaluating, justifying risk and profitability of a deal
- Affordability	
Provide recommendations regarding the affordability to enterprise clients and propose long-term, mid-term and short-term financing solutions. Compute clients' ability to repay loan, estimate time for debt repayment given amount of debt, interest rates, and available funds.	**Basics in client's affordability for recommendation on repayment** • Recommending clients' affordability ○ Computing ability to repay debt e.g., Loan amount e.g., Interest amount e.g., Available fund ○ Proposing adequate time horizon e.g.. mid-term e.g., long-term ○ Facilitating client to improve e.g., Repayment ability as per debt amount, interest rate and available funds upon origination e.g., Time for debt repayment
Evaluation of Credit Acquisition	
Evaluate the performance of credit business and identify factors affecting the performance. Analyse the hit rate on credit acquisition and calculate the success rate on different types of business (e.g. credit products, clients' segments). Analyse failed cases in credit acquisition and conduct relevant analysis (e.g. competitor analysis) to identify the causes.	**Basics in evaluation of credit acquisition for identification of root causes** • Tracking and analyzing the hit rate which is subject to definition in specific A.I. and products ○ Analyzing and identifying the factors to replicate success • Tracking and analyzing the failed rate ○ Root cause analysis of factors of failure to improve credit acquisition

3.2 Submodule 2: Consultation, Presentation, Negotiation and Code of Ethics

3.2.1 ILO

Upon completion of learning, the learners will understand and integrate the skills of consulting, presenting, and negotiating to cater to a wide range of enterprise needs, from general to large-scale enterprises.

ILO

Code of Ethics, Communication of Risk, Behavioural Knowledge, and Skills

- Have an overview of ethics and sales compliance
- Communicate risk and checking understanding, situational approach and skill sets adopted for different circumstances
- Acquire behavioural knowledge and skills of consultation, presentation and negotiation

Consultation Process

- Pre-consultation preparation to identify customer needs and evaluate suitability
    - Identify client's needs, potential, challenges, opportunities and prospects of the client with analysis of
        - Know your customers (KYC)
        - Understand the business model
        - Understand the value chain
- Consultation flow, approaches and skill set to customize consultancy service
    - Outline bank products and associated risk
    - Prescribe financial solutions per financial situation and risk
    - Elucidate credit facility structure and associated risk
    - Explore collateral valuation and relevant associated loan risk
    - Outline pricing and affordability

Presentation Process

- Pre-presentation preparation with experts to increase the odds of success
    - Collaborate with experts
    - Prepare profound professional responses
    - Build presentation around key drivers with honesty, sincerity and integrity
- Presentation flow, sales approaches and skill set to close deals
    - Manage expectations
    - Handle inquiries
    - Identify buying signals
    - Gain commitment
    - Close a deal with client satisfaction

Negotiation Process

- Pre-negotiation preparation with experts to plan negotiation tactic
  - Develop balanced offer with focus on essential attributes
  - Evaluate negotiation paradigm and strength
  - Evaluate negotiation position
  - Anticipate concerns and objections
  - Anticipate and assessing client’s counteroffer
  - Plan and execute for exit strategy
- Negotiation flow, approaches and skill set to maximize bank’s outcomes
  - Frame the negotiation
  - Create values for both counterparts
  - Adapt to situations
  - Gain commitment
  - Close a deal with customer satisfaction and maximum bank’s outcomes
  - Plan step-by-step for negotiation tactic development

3.2.2 Content

The training programme designers may refer to the following list for the design of the learning and teaching programme.

<table>
<tr><th colspan="2">Module 3 – Submodule 2
Consultation, Presentation, Negotiation and Code of Ethics</th></tr>
<tr><th>UoC Performance Requirements
(Exact stipulation in the UoC)</th><th>Suggested Learning/Teaching</th></tr>
<tr><td colspan="2">Overview on Code of Ethics, Communication or Risk, Behavioural Knowledge, and Skills</td></tr>
<tr><td>Demonstrate professional communication and presentation skills in order to communicate the proposal clearly.</td><td rowspan="3">Overview
- Ethics and sales compliance
e.g., Code of ethics
e.g., In house code of conducts
e.g., In house sales compliance
e.g., Risk clarification with clients
- Communicating risks and checking understanding,
- Behavioural Knowledge and skills of consultation, presentation and negotiation
• Consultation
• Presentation
• Negotiation
e.g., nature of dialogues
e.g., parties' relation
e.g., principal objectives
e.g., organization behaviours
e.g., situational approach/strategy/style
e.g., key success drivers
e.g., success measures
e.g., flow
e.g., skill sets
- Behavioural skills of consultation, presentation and negotiation</td></tr>
<tr><td>Demonstrate professional knowledge in business negotiation by evaluating different negotiation strategies and theories in consumer psychology and applying them aptly according to the situations.</td></tr>
<tr><td>Communicate risks to customers in accordance with sales compliance and check client's understanding.</td></tr>
<tr><td colspan="2">Consultation Process</td></tr>
<tr><td colspan="2">-Pre-consultation preparation on clients' needs identification and evaluation</td></tr>
<tr><td>Analyse the strategic direction and major business initiatives to identify the future potential, challenges, and opportunities of the company.</td><td>Basics in consultation for customizing consultation to identification and evaluation of client's needs
- Identifying clients' needs, potential, challenges, opportunities and prospects of the client with analysis of Know your customer (KYC)
- Financial analysis
• Understand and evaluate the accounting concepts applied in the client
• Conduct financial ratio analysis
- Financial strength assessment
• Conduct critical analysis of financial statements (internal factors)</td></tr>
</table>

	• Conduct critical analysis of financial statement (external factors) - Credit risk analysis • Conduct budget and pro-forma analysis to help identify client's purpose and objectives for loan demand - Clarifications • To fill up gaps between coherence of plan, actuals and outcomes of business strategy, business model and value chain • Clarify about the future potential, challenges, and opportunities
Evaluate the business models and identify factors that may impose significant effects on their earnings and cost structures hence to predict the prospect of the business	**<u>Understanding the business model</u>** - Financial analysis • Obtain qualitative financial information and associate it with financial ratios • Analyse key business drivers in coherence with business direction - Financial strength assessment • Conduct critical analysis of financial statement (internal critical risk factors) - Credit risk analysis • Conduct budget and pro-forma analysis to estimate the business or project value • Conduct quantitative analysis and risk assessment to evaluate business model achievability - Clarifications • To fill up gaps between coherence of plan, actuals and outcomes of business strategy, business model and value chain • Clarify about the future potential, challenges, and opportunities

<table>
<tr>
<td>Analyse the value chain of the business and adopt a holistic consideration to assess opportunities and risks associated with the client’s operations.</td>
<td><u>Understanding the value chain</u>
- Financial analysis
• Analyse key business drivers to understand the value chain of the business to have holistic view
- Financial strength assessment
• Conduct critical analysis of financial statement with site visits
• Conduct critical analysis of financial statement (to evaluate business model)
- Credit risk analysis
• Conduct quantitative analysis and risk assessment to evaluate value chain sustainability e.g., impacts to value chain
• Structure credit facility to know impact on balance sheet e.g., debt-equity ratio
- Clarifications
• To fill up gaps between coherence of plan, actuals and outcomes of business strategy, business model and value chain
• Clarify about the future potential, challenges, and opportunities</td>
</tr>
<tr>
<td colspan="2">-Consultation Flow, Approaches and Skill Sets to Customize Consultancy Service</td>
</tr>
<tr>
<td>Explain features and risk levels of different alternatives and use appropriate methods to ensure clients have an accurate understanding.</td>
<td rowspan="4">Basics in consultation flow for enhancing client’s credit risk management
- Consultation matrix of flow, approaches and skill sets to customize consultancy service
• Flow
○ Outlining bank products and associated risk
○ Prescribing financial solutions per financial situation and risk
Identify client’s needs
Evaluate the client’s situation
Explain features, risks, alternatives
○ Elucidating credit facility and associated risk
○ Exploring collateral valuation and relevant associated loan risk
○ Outlining pricing and affordability
• Approach
• Skill set</td>
</tr>
<tr>
<td>Provide customized consultancy service on credit risks in accordance with the financial situation and risk bearing ability of each enterprise client</td>
</tr>
<tr>
<td>Identify customers’ needs on consultancy service related to credit risk based on their business model, knowledge on the products acquired, etc.</td>
</tr>
<tr>
<td>Evaluate the situation of clients and provide advice on the suitable alternatives on investment/ settlement methods in accordance with their unique financial situation and needs.</td>
</tr>
</table>

<table>
<tr><th colspan="2">Presentation Process</th></tr>
<tr><td colspan="2">-Pre-presentation preparation with experts to increase the odds of success</td></tr>
<tr><td>Evaluate the business negotiation continuously and make appropriate changes in sales approach in order to increase the odds of success.</td><td rowspan="2">Basics in presentation preparation to increase the odds of success
- Matrix of pre-presentation preparation around key drivers with experts to increase the odds of success:
Collaborating with experts
-Product expert: product knowledge
-Credit risk expert: risk tolerance clarification
-Sales team head: competitor analysis
-Legal and compliance expert: regulatory compliance gaps
-Treasury expert: funding solutions
-IT expert: tailored data analytics
Preparing profound professional responses with technical competency and adaptation to
-Anticipated technical inquiries
-Anticipated objections
-Scenario planning
-building the presentation
Building presentation around key drivers
-Knowing the product, customers, solutions offering
-Adjusting the presentation to anticipate technical inquiries and objections to current needs
-Building the presentation on honesty, sincerity, and integrity</td></tr>
<tr><td>Make enough preparation to forecast possible enquiries or objections from clients and get proper answers ready in advance.</td></tr>
<tr><td colspan="2">-Presentation Flow, Approaches and Skill Sets to Close Deals</td></tr>
<tr><td>Manage the expectations of clients in order to preserve a long-term harmonious relationship with them</td><td rowspan="3">Basics in presentation flow to increase the success of closing a deal
- Matrix of Presentation flow, approaches and skills to gain commitment and close deals with client satisfaction:
Flow
Managing expectations
Handling inquiry and objections
Identifying buying signal
Gaining commitment
Closing a deal with client satisfaction
Approach
Skill Set</td></tr>
<tr><td>Handle the inquiries from clients professionally to address technical issues in order to close the deals with client satisfaction.</td></tr>
<tr><td>Be client focused by paying attention to prospects' buying signals and gain their commitment at appropriate time by using suitable closing techniques.</td></tr>
</table>

<table>
<tr><th colspan="2">Negotiation Process</th></tr>
<tr><td colspan="2">-Pre-Negotiation Preparation with Experts to Plan Negotiation Tactic</td></tr>
<tr><td>Be client focused and identify the negotiation styles of prospects to adapt to their styles while planning the negotiation strategies.</td>
<td rowspan="2">Basics in negotiation preparation to develop negotiation tactics
- Pre-negotiation preparation with technical specialists to plan negotiation strategy:
• Developing balanced offer
○ Focus
▪ Long term interest
▪ Short term interest
▪ Bottomline
▪ Best alternative to a negotiated agreement
▪ Solutions – options
▪ Solutions – concession
▪ Leverage components e.g. legitimacy, commitment, relationship, communication
○ Expected outcomes
• Evaluating negotiation paradigm and strength
○ Anticipating negotiation paradigm, behavioral clashes and ethical boundary
• Evaluating negotiation positions e.g. information, place, power
• Anticipating concerns and objections
• Anticipating and assessing client’s counteroffer for structuring and restructuring of the transaction
• Planning and executing for exit strategy</td></tr>
<tr><td>Be well prepared in coordination with different technical specialists to restructure the proposal according to clients’ needs, if necessary.</td></tr>
<tr><td colspan="2">-Negotiation Flow, Approaches and Skill Set to Maximize Bank’s Outcomes</td></tr>
<tr><td>Demonstrate professional knowledge in business negotiation by evaluating different negotiation strategies and theories in consumer psychology and applying them aptly according to the situation.</td>
<td rowspan="3">Basics in negotiation flow to maximize bank’s outcomes
- Matrix of negotiation flow including
• Framing the negotiation
• Creating values for both counterparts
• Adapting to situations
• Gaining commitment
• Closing a deal with customer satisfaction
• Step-by-step planning for negotiation tactic development:
- The effective negotiation flow rides on content and tactics derived from the negotiation</td></tr>
<tr><td>Assess the bottom line of prospects (i.e., must have, should have, nice to have) in order to propose a compromise solution.</td></tr>
<tr><td>Determine the bottom line of the bank and develop different concessions alternatives with an attempt to maximize the bank’s outcomes.</td></tr>
</table>

<table>
<tr>
<td>Evaluate the position of the bank and client by estimating the risks exposure faced by the bank and evaluating against its risk tolerance ability when restructuring the position.</td>
<td rowspan="4">preparation and contains the essential elements of

Communicating
Identifying interest
Identifying actual needs
Identifying bottom line
The client

Must have
e.g., risk & compliance perspective
Should have
Nice to have

The bank

Must have
Should have
Nice to have

Identifying alternatives
Identifying options

Balanced Offer
Concessions

Identifying people

Negotiation styles

Evaluating position of

The client
The bank

Anticipating potential concerns and objectives of

The client
The bank

Assessing client’s offer
Understanding client’s decision criteria and legitimacy
Gaining commitment
Exiting, if necessary

Exit strategy

When
How

</td>
</tr>
<tr>
<td>Anticipate the potential concerns and objections of the prospects in order to develop possible counter-solutions to pre-empt their concerns.</td>
</tr>
<tr>
<td>Address actual client needs during negotiation and employ influencing and persuasive skills to provide compelling reasons to facilitate the decision-making process of clients.</td>
</tr>
<tr>
<td>Determine when to withdraw from the negotiation if a feasible/profitable deal cannot be achieved and conduct the closure professionally and tactically.</td>
</tr>
</table>

4. Learning Modes and Methods

There are three suggested learning modes:

Self-study: Learners read materials, complete assignments, pre-class refreshers, and pre-class assessments where applicable and provided by the trainer, and complete the learning activities to elevate awareness of the content.

Class: Learners have contact with the trainer and other RPs for interactive learning/assessment activities to improve knowledge and application of skills to result in desirable behaviours.

Case: Learners extend learning beyond class with a simulation case in which the trainer will score the performance outcomes upon case completion.

5. Learning Context

Learners are best to learn in the work case context. Therefore, in all the suggested learning modes, learners are encouraged to refer to work cases to understand the knowledge, apply the skills, and arrive at the required behaviours to complete learning activities.

In some situations where sharing with peer learners on work cases might be inappropriate (e.g., when the training programme is open to enrolment to RPs from different commercial banks), Users may consider providing cases with simulated situations.

6. Format of Teaching and Learning Resources

Self-study: Suggest that learners schedule the completion of learning tasks at their paces within the defined time frame.

Class: Suggest that trainers conduct the class in an interactive workshop format to allow learners to maximize their proactive learning.

Case: Suggest that learners schedule the completion of the simulation case at their paces within the defined time frame.

7. Learning Activities, Time Allocation and Reference Sources

7.1 Learning Activities and Time Allocation

The Training Package suggests that both learning, and assessment activities are for learning and sharing to improve knowledge, application of skills, and achievement of behaviours.

Assessment activities are also learning activities. Users may also refer to assessment activities in Part F to arrive at an overall picture of all learning opportunities created for learners.

The tables below show the suggested learning activities, categorized by learning modes and their corresponding time allocations.

It is important to note that Module 3, especially Submodule 2, which focuses on consultation, presentation, and negotiation, requires a high degree of engagement with the content and its flow. As a result, the time allocation for learning activities within this module has been deliberately segregated. This segregation is designed to underscore the need for learners to invest the same level of attention and effort into these activities as they would in other areas of their learning. This strategic approach is key to ensuring that learners are thoroughly prepared to effectively articulate content, flow, and skills in a range of professional settings, both within the organization and with external clients.

Learning Activities Trainers assign self-study 1, 2, 3, 4, and selection from 10 of each submodule for completion before class.		NLH Module 1				NLH Module 2			
Description	Administration Details	Self-Study	Class		Post-Class Case	Self-Study	Class		Post-Class Case
			Inter-active	Assess-ment			Inter-active	Assess-ment	
1.Reading The learner reads the materials or accesses to internet information assigned by the trainer.	Section E 7.3.1	36	-	-	-	22	-	-	-
2.Self-assessment on UoC required performance outcomes The learner reflects on competency based on past work cases handled.	Section E 7.3.2	12	-	-	-	8	-	-	-
3.Suggestion on credit guideline The learner reflects on the existing credit guidelines and makes suggestions on improvement area(s) which might enhance CRM.	Section E 7.3.3	22	-	-	-	9	-	-	-
4.Preparation of the "Best Credit Case Handled" Presentation The learner selects the best credit case handled and prepares a presentation deck for sharing in the class.	Section E 7.3.4	45	-	-	-	27	-	-	-
5.Newsroom The learner raises awareness of the importance of the subject credit risk management with current and past credit cases with valuable lessons learned.	Section E 7.3.5	-	3	-	-	-	1.5	-	-
6.Interactive learning (lecture) The trainer gives lecture or invites questions from the learners.	Section E 7.3.6	-	8	-	-	-	5	-	-
7.Practice – "Best Credit Case Handled" presentation The learner presents relevant work cases prepared above for sharing.	Section E 7.3.7	-	5	-	-	-	3	-	-
8.Practice - case drill The learner shares the experience about external factors and internal factors affecting the credit qualities of chosen cases from presentations.	Section E 7.3.8	-	3	-	-	-	1.5	-	-
9.Seminar on updates and case experience on operational risk and regulatory risk The trainer/guest shares updates and work case experience.	Section E 7.3.9	-	6	-	-	-	-	-	-
10.Simulation case (to be completed in 4 weeks after class) The learner completes a simulation case with the performance outcomes to be scored by the trainer.	Section E 7.3.10	-	-	-	105	-	-	-	63
11.Assessment		-	-	15	-	-	-	10	-
Total		115	25	15	105	66	11	10	63

Learning Activities **Trainers assign self-study 1, 2, 3, 4, and selection from 10 of each submodule for completion before class.**		**NLH** **Module 3.1 (Credit facility structure of bank products)**				**NLH** **Module 3.2 (Consultation, presentation, negotiation)**			
Description	Administration Details	Self-Study	Class		Post-Class Case	Self-Study	Class		Post-Class Case
			Inter-active	Assess-ment			Inter-active	Assess-ment	
1.Reading The learner reads the materials or accesses to internet information assigned by the trainer.	Section E 7.3.1	27	-	-	-	4	-	-	-
2.Self-assessment on UoC required performance outcomes The learner reflects on competency based on past work cases handled.	Section E 7.3.2	6	-	-	-	6	-	-	-
3.Suggestion on credit guideline The learner reflects on the existing credit guidelines and makes suggestions on improvement area(s) which might enhance CRM.	Section E 7.3.3	9	-	-	-	1	-	-	-
4.Preparation of the "Best Credit Case Handled" Presentation The learner selects the best credit case handled and prepares a presentation deck for sharing in the class.	Section E 7.3.4	9	-	-	-	9	-	-	-
5.Newsroom The learner raises awareness of the importance of the subject credit risk management with current and past credit cases with valuable lessons learned.	Section E 7.3.5	-	0.5	-	-	-	0.5	-	-
6.Interactive learning (lecture) The trainer gives lecture or invites questions from the learners.	Section E 7.3.6	-	2	-	-	-	2	-	-
7.Practice – "Best Credit Case Handled" presentation The learner presents relevant work cases prepared above for sharing.	Section E 7.3.7	-	1	-	-	-	1	-	-
8.Practice - case drill The learner shares the experience about external factors and internal factors affecting the credit qualities of chosen cases from presentations.	Section E 7.3.8	-	0.5	-	-	-	0.5	-	-
9.Seminar on updates and case experience on operational risk and regulatory risk The trainer/guest shares updates and work case experience.	Section E 7.3.9	-	1	-	-	-	-	-	-
10.Pre-class refresher, assessment case and simulation case for post-class extended learning (trainer sets the due date) The learner completes a simulation case with the outcomes scored	Section E 7.3.10	25	-	-	21	32	-	-	21
11.Assessment			-	3	-		-	3	-
Total		76	5	3	21	52	4	3	21

7.2 Reference Sources for Learning Activities

Trainers may refer to the table below for suggestions to construct materials for all the proposed learning activities, where details of administration process are in the next section.

Learning Activities	Materials Prepared by Trainers
1.Reading	Potential list of pre-class sources: - UoC - SPM - The HKMA Research - The HKMA Circulars - Banks' Credit Guidelines - Books on Credit Risk Management - The Basel Principles - Current Development in CRM technology - Content Notes for Reference
2.Self-assessment on UoC required performance outcomes	One self-assessment form per submodule for each learner to conduct self-assessment on performance outcomes
3.Suggestion on credit guideline	One credit guideline suggestion form per submodule for each learner to put down improvement suggestions
4.Preparation of the "Best Credit Case Handled" Presentation	One guide per submodule for each learner to follow to prepare the presentation deck on work case analysis
5.Newsroom	One publicly known credit case per submodule
6.Interactive learning (lecture)	Tailored learning contents as per outlined in the training package and audience needs
7.Practice – "Best Credit Case Handled" presentation	One scorecard per submodule
8.Practice - Case drill	A set of facilitation questions
9.Seminar on updates and case experience on operational risk and regulatory risk	Sessions to share updates on key regulations, operational risk, compliance and relevant cases, from general enterprise to large and complex enterprise
10.Pre-class refreshers, assessment case and simulation case for post-class extended learning	Refresher questions/multiple choices on prior modules, KYC and ethics, assessment case and post-class simulation case for extended learning
11.Assessment	Assessment question, simulation case for post-class extension learning to ascertain the learner's performance

The trainer may design an integrated learning progress registration card for learners to monitor and report their completed learning activities. A sample is available on the next page.

7.3 Activity Objective, Administering Process and Samples

SAMPLE: Learning progress registration card for learners to monitor and report the completion status of the learning activities

Learning progress registration card (Learners to fill in and send to Trainer upon completion of all Modules)			**Module 1**					**Module 2**		
			Sub module 1	**Sub module 2**	**Sub module 3**	**Sub module 4**	**Sub module 5**	**Sub module 1**	**Sub module 2**	**Sub module 3**
1.	Reading (High Priority=50% time; Medium Priority=30% time, Low Priority=20% time)	Completed the Reading (put a tick ✓)								
2.	Self-assessment on UoC required performance outcomes	Actual Score (self-scored)								
		Maximum Score	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set
3.	Suggestion to improve credit guideline	Passed to the supervisor (Put a tick ✓)								
4.	Preparation of "Best Credit Case Handled" presentation	Completed the Reading (put a tick ✓)								
5.	Newsroom	Name of Case Discussed								
6.	Interactive learning (lecture)	Attended the Class (Put a tick ✓)								
7.	Practice – "Best Credit Case Handled" presentation	Actual Score from trainer								
		Maximum Score	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set
8.	Practice - Case Drill	Name of Case Discussed								
9.	Seminar on updates and case experience on operational and regulatory risk	Attended the Seminar (put a tick ✓)								
10.	Simulation case	Actual Score from trainer								
		NLH logged								
		Maximum Score	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set

Note 1: The maximum scores are pre-set by the trainer
Note 2: Learners submit the registration card via email to the trainer 1 week before start of the Modules and 4 weeks after end of all submodules within each Module
Note 3: Learners having completed the self-study activities 1, 2, 3 and 4 are admitted to the class
Note 4: Learners having completed all learning activities and assessment will receive performance grade

SAMPLE: Learning progress registration card for learners to monitor and report the completion status of the learning activities

Learning progress registration card (Learners to fill in and send to Trainer upon completion of all Modules)			**Module 1**					**Module 2**			**Module 3**	
			Sub module 1	**Sub module 2**	**Sub module 3**	**Sub module 4**	**Sub module 5**	**Sub module 1**	**Sub module 2**	**Sub module 3**	**Sub module 1**	**Sub Module 2**
1.	Reading (High Priority=50% time; Medium Priority=30% time, Low Priority=20% time)	Completed the Reading (put a tick ✓)										
2.	Self-assessment on UoC required performance outcomes	Actual Score (self-scored)										
		Maximum Score	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set
3.	Suggestion to improve credit guideline	Passed to the supervisor (Put a tick ✓)										
4.	Preparation of "Best Credit Case Handled" presentation	Completed the Reading (put a tick ✓)										
5.	Newsroom	Name of Case Discussed										
6.	Interactive learning (lecture)	Attended the Class (Put a tick ✓)										
7.	Practice – "Best Credit Case Handled" presentation	Actual Score from trainer										
		Maximum Score	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set
8.	Practice - Case Drill	Name of Case Discussed										
9.	Seminar on updates and case experience on operational and regulatory risk	Attended the Seminar (put a tick ✓)										
10.	Pre-class refreshers, assessment case, and post-class simulation case	Actual Score from trainer										
		NLH logged										
		Maximum Score	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set	Pre-set

Note 1: The maximum scores are pre-set by the trainer
Note 2: Learners submit the registration card via email to the trainer 1 week before start of the Modules and 4 weeks after end of all submodules
Note 3: Learners having completed the self-study activities 1, 2, 3, 4, pre-class refreshers and assessment case in 10 are admitted to class
Note 4: Learners having completed all learning activities and assessment will receive performance grade

7.3.1 Reading

Objective of this Suggested Learning Activity

This suggested learning activity enables learners to have foundational understanding of key concepts, enabling learners to engage more effectively in class activities. These materials introduce essential theories, case studies, and industry practices, ensuring that learners are adequately prepared for deeper exploration and practical application during class sessions. Additionally, such readings stimulate critical thinking and curiosity, fostering a more interactive and enriching learning experience.

Suggested Administering Process

- This is a pre-class learning activity.
- This activity is designed for self-paced learning, allowing learners to engage with the materials at their own speed within the suggested time allocation as part of self-study approach.
- Trainers will provide the appropriate reading list and/or notes along with a welcome letter, emphasizing the critical role of pre-class reading in establishing a foundational understanding of the key concepts.
- Each learners registers the completion of this learning activity on the learning progress registration card.

Sample

Sample lists of suggested pre-class reading and optional pre-class reading for trainers' reference and their suggestions to learners are available in Section G4, Appendices 2 and 3.

7.3.2 Self-Assessment on UoC required performance outcomes

Objective of this Suggested Learning Activity

This suggested learning activity enables learners to have a head start on the required performance outcomes of the submodule. For example, while referring to past credit cases handled for completion of the self-assessment form, the learner gets an overall idea of the performance outcomes to improve so as to enhance his awareness to extract relevant learnings from peer learners when he attends the class.

Suggested Administering Process

- This is a pre-class learning activity.
- It is a self-paced learning task using self-study methodology.
- The training programme designer prepares one self-assessment form for each submodule.
- The trainer provides the completed self-assessment forms to learners at the beginning of the training programme.
- Each learner shares the self-assessment form with the direct supervisor/named delegate and registers the completion of the learning activity on the learning progress registration card.

Sample

A sample self-assessment form is provided on the next page.

Sample

Sample - Self-Assessment Form
on UoC Required Performance Outcomes
Module 1 submodule 1 – Early Warning Signal

Note to learners:
Please refer to the credit cases during the last 12 months in which you have successfully identified (or failed to identify) early warning signals of loan accounts/loan portfolios to complete the following self-assessment form. Please share the completed self-assessment form with your direct supervisor/named delegate, then register completion in your integrated scorecard for Module 1 submodule 1 under "Self-Assessment."

Instructions:
- *Please answer top of mind response – that which comes first to your mind*
- *Put a tick in the box that is most representative of you at this point in time*

Required Performance Outcomes	5	4	3	2	1
Monitoring of portfolio – theory and practice					
• Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring					
• Understand the credit strategies and portfolio objectives of the bank in order to identify crucial areas for monitoring					
• Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt remedial actions					
• Identify sources and causes of the changes in risk level, e.g., underwriting standards, economic conditions, personnel issue and recommendation					
• Demonstrate professionalism by applying impartial and unbiased judgment throughout the loan portfolio assessment process					
Identify credit indicators – account and portfolio					
• Monitor and ensure credit administration in compliance with contractual requirements and facility terms					
• Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios					
Identify relationship between risk level change and loan provision					
• Regularly review the advantage and weakness of forecasting, reviewing approaches and adopting the most reliable measures					
Identify key regulations, report remedy to management and make recommendations					
• Report to senior management about the results of analysis on risk profile of overall loan portfolio.					

5: Demonstrate daily and continuously
4: Demonstrate frequently
3: Demonstrate sometimes
2: Demonstrate infrequently
1: Demonstrate rarely

7.3.3 Suggestion to improve credit guideline

Objective of this Suggested Learning Activity

This suggested learning activity sensitizes learners about banks' credit strategies, key regulations, and the credit operational risk management cascaded and embedded into the credit guidelines.

The learner refers to past credit cases handled to identify root causes of the failures (or successes) in detecting early warning signals and to suggest improvements. These are to be embedded in credit guidelines to improve the timeliness of identifying early warning signals.

The learner reviews relevant past credit cases and credit guidelines to accomplish this learning activity. The review and reflection process will increase the learner's awareness of the bank's strategy, key regulations, and credit risk operations.

Suggested Administering Process

- This is a pre-class learning activity.
- It is a self-paced learning task during self-study.
- The trainer prepares one improvement suggestion form for each submodule.
- The trainer passes the improvement suggestion forms to learners at the beginning of the training programme.
- The learner shares the completed suggestion form with the direct supervisor/named delegate and registers the completion of this learning activity on the learning progress registration card.

Sample

A sample suggestion form is provided on the next page.

Sample

<u>Sample – Suggestion Form</u>
<u>Suggestion on Credit Guideline</u>
<u>Module 1 submodule 1 – Early Warning Signal</u>

Note to learners:
Learners should be familiar with all relevant credit guidelines. This learning activity helps to sensitize yourself about the importance of continuous improvement of credit guidelines in credit risk management.

Step (1) *Please refer to credit cases during the last 12 months in which you have identified (or failed to identify) early warning signals of loan accounts/loan portfolios. Then, reflect on the principal reasons for the success or the failures.*

Step (2) *To help the reflection, you may refer to (1) practices of other local and foreign banks, (2) research papers from the HKMA and the BASEL committee, and (3) research papers from other sources.*

Step (3)
Based on your findings and reflection, make one suggestion to achieve a more timely and effective identification of early warnings, e.g.,
- *Enhanced internal standards*
- *Enhanced practices*
- *Enhanced reporting process*
- *Enhanced escalation process*

Step (4) *To sustain the benefits of the above suggestions, please propose a credit guideline to embed it. The improvement suggestion should be proportionate to the bank's risk exposure level.*

Step (5) *Share the completed suggestion form with your direct supervisor/named delegate and register the completion of this learning activity.*

Credit guideline	Name of the credit guideline
Description of pain points	No pre-set word limit
Improvement suggestion	Suggest in 200 words
Benefits of implementing the suggestion	Describe in 100 words the benefits from the suggestion if it is implemented
Reference	List the credit risk management principles enlisted by BASEL or the HKMA. Key regulations should be considered

Sample Analysis

Pain point
E.g., timely identification of credit rating deterioration. The learner might have observed from several past cases that there has been a long-time gap between the occurrence of a trigger, e.g., utilization of OD exceeds the past six months' average rate and the rating deterioration.

Improvement suggestion
E.g., embed the following improvement in the named credit guideline: "Have the designated committee discuss early warning signals each week on zoom instead of bi-monthly in the meeting rooms".

Benefits of the improvement suggestion
E.g., one of the three quoted past cases would have reduced loss by the estimated amount or percentage.

Relevant BASEL principle
E.g., the learner may quote principle No 8: "Banks should have in place a system for their various credit-risk-bearing portfolios." Banks should ensure the accuracy and timeliness of information provided to management information systems. (Basel Committee Publications - Principles for the Management of Credit Risk - Oct 2000 (bis.org)

7.3.4 Preparation of the "Best Credit Case Handled" Presentation

Objective of this Suggested Learning Activity

This suggested learning activity requires learners to organize the case information according to the credit risk management process, i.e., identification of risk factors, measurement of risk level, and managing and controlling risk. In addition, the preparation process allows the learner to do a systematic walk-through of the case. The walk-through will increase the learner's confidence and readiness to tell the story via presentation in the class.

If work case sharing is inadequate (e.g., the training programme is open to public enrolment), the trainer may consider providing a simulated case for preparation and presentation.

Learner's selection of work case, or the trainer's selection of provided simulation case may align with the "Training Content Prioritization Reference Grid for High Priority" in Section E. Learners may also follow the guidance from the reference grid below.

Reference	Suggestions for learners	Local/international case sources
Update in bank focus	-Identify recent work cases or cases from publicly available sources, such as bank's annual reports or press release.	Bank websites with annual reports, press releases; or credible global news sources.
Update in HKMA focus	-Review recent work cases or publicly available reports on HKMA's current priorities or regulatory focus areas for insight on potential cases.	-HKMA website with public reports, strategic focus areas, or regulatory international bodies.
Update in HKMA Guide	-Look for recent work cases or publicly accessible credit cases, local or international that simulate (or not) compliance challenge with HKMA guidelines.	-HKMA website with guidelines and regulatory updates, or websites of regulatory bodies mentioning case studies
Update in QFHK SCS	-Search for recent work cases or publicly accessible credit cases, local or international, that reflects competencies accomplishment outlines in the QFHK SCS based UoC.	-Publicly available reports on reliable sources with local or global case studies.

Suggested Administering Process

- This is a pre-class learning activity in preparation for in-class presentation.
- The trainer prepares one presentation scorecard with instructions and scoring criteria for the presentation of each submodule.
- The trainer passes the presentation scorecards to the learners at the beginning of the training programme.
- Each learner prepares a PPT presentation deck for a 5-minute presentation in the class.
- Each learner shares the PPT presentation deck before the class with the direct supervisor/named delegate and registers completion of the learning activity on the learning progress registration card.

Sample

A sample preparation guide is provided on the next page.

Sample

Sample – Preparation Guide
For "The Best Credit Case Handled" Presentation
Module 1 submodule 1 – Early Warning Signal

Note to learners:
Please refer to credit cases handled during the last 12 months in which you have successfully identified (or failed to identify) early warning signals of loan accounts/loan portfolios to select the one which gives you valuable lessons learned. Please follow the preparation guide below to prepare a PowerPoint deck. You are to provide a 5-minute on-the-stage presentation during the class (or in small groups) for feedback from peer learners/the trainer. Please share the completed PowerPoint deck with your direct supervisor/named delegate and register the completion of this learning activity.

Step 1	Please select a work case in which you have attempted to demonstrate some or all of the following knowledge, skills and behaviours to identify relevant early warning signals. **Monitor portfolio – theory and practice** - Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring - Understand credit strategies and portfolio objectives of the bank in order to identify crucial areas for monitoring - Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt remedial actions - Identify the sources and causes of the changes in risk level, e.g., underwriting standards, economic conditions, personnel issue and recommend - Demonstrate professionalism by applying impartial and unbiased judgment throughout loan portfolio assessment process **Identify early warning signals** - Monitor and ensure credit administration in compliance with contractual requirements and facility terms - Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios **Identify relationship between risk level change and loan provision** - Regularly review the advantage and weakness of forecasting, and reviewing approaches and adopt the most reliable measures **Identify key regulations, report remedy to management and make recommendations** - Report to senior management about the results of analysis on risk profile of overall loan portfolio

Step 2	Prepare a PowerPoint Deck to enhance the organization of your analysis for the presentation in class. The 5-minute presentation should include the following contents: **<u>Monitoring of portfolio – theory and practice</u>** For example, one page on "Understanding the Client - Case Background" e.g., describe economic sector, and industry of the client e.g., describe the scale of the client, loan type, and loan size e.g., describe the credit risk assessment upon booking and status as of the preparation date For example, one page on "Identifying the Risk - Critical Risk Factors" e.g., describe the essential economic, industrial, internal risk factors identified at the time of loan booking and the subsequent emergence of risk factors, where applicable e.g., describe whether the emergent risk factors, if applicable, apply to the specific loan or to the portfolio

	<u>Identify early warning signals</u> For example, one page on Identification of credit risk indicators - describe relevant credit risk indicators for day-to-day monitoring - describe the detected early warning signals - describe how the judgment about the early warning signals has taken place **<u>Control the risk - identify the relationship between risk level change, loan provision, and others</u>**. For example, one page on "Estimation of the Potential Impact of the Risk Level Changes" to explain the consequence of early warning signals left undetected (e.g., increased loan provision, increased cost, reputation risk, and others). **<u>Make recommendation - identify key regulations, report remedies to management, and make recommendations.</u>** For example, one page on "The Reporting to Senior Management about the Case Outcomes" - remedial actions - suggested future measures - lessons learned *Please be reminded to exclude company names in the deck*

7.3.5 Newsroom

Objective of this Suggested Learning Activity

This suggested learning activity serves both as an ice-breaking tool to kick-start a class and an introduction to the ILO of the submodule. At the beginning, the trainer will select one notorious case with valuable credit risk management lessons learned. After this approximate 30-minute interactive session, the learner is likely to echo the importance of the ILO of the submodule.

Suggested Administering Process

- This is an in-class learning activity.
- The trainer will prepare a list of publicly known cases (or cases he has handled) that match with the ILO of the submodule.
- The trainer will select one case for this learning activity.
- The trainer will prepare a set of facilitation questions to enable learners to draw out the critical lessons learned from these cases.
- The trainer may start the session by inviting learners to reveal how much they know about the circumstances and draw out lessons learned.
- Each learner registers the completion of this learning activity on the learning progress registration card.

Sample

A sample set of facilitation questions is provided on the next page; whereas sample source materials and links are provided also provided in section 7.4.

Sample

Sample – Newsroom
Publicly Known Cases
Module 1 submodule 1 – Early Warning Signal

Sample questions from the trainer	Possible discussion points raised by the learners
Introduction	
Have you noticed the credit-related news of Country X lately?	e.g., country X has defaulted for the first time its sovereign bond
Trigger	
What is the trigger of this credit event?	e.g., country X has been unable to pay the interest/principal
Root Causes	
What are the root causes of this trigger?	e.g., possible Root Causes (1) e.g., possible Root Causes (2)
Early Warning Signals	
What early warning signals give signs of credit quality deterioration and when? What are the means to verify the signals or to estimate the probability of happening?	e.g., credit rating deterioration [may specify changes with time] e.g., government statements [may select content and date] e.g., market news [may select sources and date]

7.3.6 Interactive learning (lecture)

Objective of this Suggested Learning Activity

This learning activity requires trainers to leverage their extensive knowledge, skills, and experience in credit risk management related subjects. The goal is to effectively communicate key concepts, their practical implications, and applications through engaging interactions with learners.

Suggested Administering Process

- This is an in-class learning activity.
- This activity is designed for classroom setting.
- Due to the intensive nature of classroom training, trainers are advised to thoroughly review the training package in advance of class. This preparation is crucial to ensure effective facilitation and content delivery, as well as for refreshing their understanding of the training's overall structure and key objectives.
- Each learner registers the completion of this learning activity on the learning progress registration card.

Sample

Sections E1, E2, and E3 of the Learning and Teaching Guide contain the comprehensive content outlines of Modules 1, 2, and 3 for the development of all the learning activities, including interactive learning (lecture).

Sections G1, G2, and G3 of the Support Materials for Trainers contain the content note suggestions on the Learning and Teaching Guide from Sections E1, E2, and E3. Trainers are responsible for ensuring that the materials adapted for the training program are current, valid, and relevant to the learners at the time of the training programme launch.

7.3.7 Practice – “Best Credit Case Handled” Presentation

Objective of this Suggested Learning Activity

This suggested learning activity requires learners to present a credit case in class. Peer learners would have the opportunity to raise questions, give feedback, share experience and practices, and make suggestions for better credit risk management. The interactive learning opportunity will elevate learners' knowledge, skills, and behaviours.

If work case sharing is inadequate (e.g., the training programme is open to public enrolment), the trainer may consider providing a simulated case for preparation and presentation.

Suggested Administering Process

- This is an in-class activity, with pre-class preparation.
- The trainer distributes the sample presentation scorecards to learners at the beginning of the training programme.
- The trainer fills in one scorecard for each presentation performed in the class
- To facilitate the presentation session, the trainer may refer to the following steps.
- Each learner registers the completion of this learning activity on the learning progress registration card.

Step 1: Before the presentation starts

- **Put a flip chart with the names of learners**
    - The trainer invites peer learners to participate in the scoring. The peer learners will come forward to mark scores for all presentations at the end of the session.

Step 2: After each presentation is done

- **The trainer completes filling in the scorecard**
    - The trainer invites peer learners to ask questions or to share experiences.
    - The trainer invites the peer learners to complete filling in the scorecard.

Step 3: After all presentations is done

- **The trainer completes filling in the scorecard**
    - The trainer asks learners to come forward to the flip chart (prepared ahead in Step 1) and give their marks under each presenter.
    - The trainer asks learners to register their marks using their learning progress registration card.

Sample

A sample presentation scorecard is provided on the next page

Sample

Sample – Presentation Scorecard
Presentation on The Best Credit Case Handled
Module 1 submodule 1 – Early Warning Signal

Scorecard
Presentation of The Best Credit Case Handled
Module 1 submodule 1 – Early Warning Signal

Notes to learners:

Before the Presentation
The trainer distributes this scorecard to each learner at the beginning of the programme.

During the Presentation
Each learner receives marks on the presentation according to the following criteria:
1. To what degree does the presenting learner cover comprehensively the required content
2. To what degree the presenting learner identifies the early warning signals comprehensively
3. To what degree does the presenting learner comprehensively estimate and monitor the risk impacts
4. To what degree does the presenting learner takes effective remedial measures and make a recommendation to the management

After the presentation
1.The trainer invites peer learners to ask questions and to share experience
2.The trainer and peer learners will give their marks to each learner after all presentations.
3.Each learner will register the scores in his own integrated self-monitoring learning progress card

Name of the Presenter:

To what degree the learner covered comprehensively the required content		**To what degree the learner identified comprehensively the early warning signals**		**To what degree the learner could comprehensively estimate and monitor the risk impacts**		**To what degree the learner took effective remedial measures and make recommendations to the management**	
Please circle the points you give to the presenter		Please circle the points you give to the presenter		Please circle the points you give to the presenter		Please circle the points you give to the presenter	
100%	5 marks	100%	5 marks	100%	5 marks	100%	5 marks
80%	3 marks	80%	3 marks	80%	3 marks	80%	3 marks
60%	1 mark	60%	1 mark	60%	1 mark	60%	1 mark
Insufficient facts	0 mark	Insufficient analysis	0 mark	Not clearly demonstrated	0 mark	Not clearly articulated	0 mark
Please add up the total of all the marks given (Maximum: 20 marks) ⇨							

Recap on the requirements for the presentation deck preparation:

Prepare a PowerPoint Deck to enhance the organization of your analysis for the presentation in class. The structure of the 5-minute presentation may include:

Please be reminded to exclude company names in the deck

Monitoring of portfolio – theory and practice

For example, one page on “Understanding the Client - Case Background”
e.g., describe the economic sector, and industry of the client
e.g., describe the scale of the client, loan type, and loan size
e.g., describe the credit risk assessment upon booking and status as of the preparation date

For example, one page on “Identifying the Risk - Critical Risk Factors”
e.g., describe the essential economic, industrial, internal risk factors identified at the time of loan booking and the subsequent emergence of risk factors, where applicable
e.g., describe whether the emergent risk factors, if applicable, apply to the specific loan or to the portfolio

Identify early warning signals

For example, one page on Identification of credit risk indicators
e.g., describe relevant credit risk indicators for day-to-day monitoring
e.g., describe the detected early warning signals
e.g., describe how the judgment about the early warning signals has taken place

Control the risk - identify the relationship between risk level change, loan provision, and others.

For example, one page on “Estimation of the Potential Impact of the Risk Level Changes” to explain the consequence of early warning signals left undetected (e.g., increased loan provision, increased cost, reputation risk, and others).

Make recommendation - identify key regulations, report remedies to management, and make recommendations.

For example, one page on “The Reporting to Senior Management about the Case Outcomes”
- remedial actions
- suggested future measures
- lessons learned

7.3.8 Practice – Case Drill

Objective of this Suggested Learning Activity

The learning activity requires learners to deep dive into the good practices leading to the successful and be aware of undesirable practices leading to non-satisfactory outcomes of credit cases. Also, learners will discuss how to sustain the best practices in credit risk management and the enhancement RPs' attitudes and behaviours.

Suggested Administering Process

- This is an in-class activity.
- After the Best Credit Case Handled presentations, the trainer invites learners to pick one or two cases for the case drill.
- The learners presenting the selected cases would provide necessary information during the case drill. Alternatively, the learners can quickly search for more related information online and raise issues for discussion.
- The trainer also discusses the potential operations risk of these selected cases to alert the learners about the importance of developing, maintaining, and complying with adequate policies and guidelines for quality credit risk management.
- Each learner registers the completion of this learning activity on the learning progress registration card.

Sample

A sample set of facilitation questions is available on the next page

Sample

Sample – Case Drill
Potential Question List
Module 1 submodule 1 – Early Warning Signal

Sample Facilitation Questions About the operations, regulations, and compliance risk of the cases	**Possible Discussion Points** Raised by the learners
Introduction	
From the Best Case Handled presented by (Learner's name), the listed Company X does not fulfill the regulatory disclosure requirements, what are some of these disclosure requirements?	Example: disclosure of pro-forma statements
Monitoring of credit quality	
Which department/unit monitors the credit quality? Does it monitor up to this kind of detail? How will the outcomes of the monitoring process reach you? What are other examples of monitoring relevant for early identification of credit quality deterioration?	Example: unit in the back office Example: only when specified in the T&C Example: retrievable from system, monthly report, weekly meeting Example: mention the relevant credit guideline or share the experience on monitoring
Best practices, attitudes, and behaviours	
What is your best practice for revealing early warning signals? What are the attitudes and behaviours to be discouraged?	Example: learners may share their own experiences of those of seniors/seasoned RPs

7.3.9 Seminar on Updates and Case Experience on Operational Risk and Regulatory risk

Objective of this Suggested Learning Activity

Regardless of their experience in credit risk management related subjects, trainers must stay abreast of the latest developments in laws, regulations, industry guidelines, inhouse operations and compliance rules updates. It's crucial to incorporate current inhouse risk cases and court cases into the training to enhance learners' capabilities. Trainers are encouraged to continuously update their knowledge and to invite specialists from various banking sectors to enrich the training and learning experience.

Suggested Administering Process

- This is an in-class activity.
- As other learning activities, this learning activity is mandatory for all learners and should be conducted in classroom setting.
- Trainers are responsible for reviewing the most recent inhouse and publicly available case studies to identify key risk areas. These case studies should form the basis for inviting specialists to share their experience and experiences with the learners.
- The training session should conclude with an interactive wrap-up, where learners actively participate in discussing the insights gained and practical applications of the concepts learned.
- Each learner registers the completion of this learning activity on the learning progress registration card.

Sample

- Sample source materials and links are provided in Section 7.4.

7.3.10 Pre-class Refreshers, Assessment Case and Post-class Simulation Case

(1)Pre-Class Refreshers on Modules 1 and 2 before attending class on Module 3

Objective of this Suggested Learning Activity

Learners review the performance requirements of Modules 1 and 2, followed by a Refresher to confirm the effectiveness of the review. This equips them with a solid foundation for Module 3, where they will develop customized financing solutions for clients.

Target Learners

- Learners should submit Modules 1 and 2 Refresher scorecards if enrolled in Module 3 over a year after completing Modules 1 and 2, or if exempted from them under the HKMA-ECF framework. Other learners do not need to submit scorecards.

Suggested Administering Process

- It is a pre-class learning activity.
- An open book Refresher is conducted.
- The trainer distributes a list of questions and a Refresher scorecard to applicable learners prior to the training program.
- The trainer collects completed Refresher scorecards by the due date.
- The trainer confirms the learners who achieve the passing mark to attend class.
- The trainer confirms the learners with below passing mark to retake before class.
- Each learner registers the completion of this learning activity on the learning progress registration card.

Sample
Appendix 5 -Sample – Refresher on Modules 1 and 2

(2)Pre-class Refresher on Module 3 before attending class on Module 3

Objective of the Suggested Learning Activities

Learners revise knowledge of the code of ethics, code of conduct, and sales compliance, ensuring they are well-prepared to integrate these crucial aspects into Module 3's learning process.

Suggested Administering Process

- It is a pre-class activity.
- An open book Refresher is conducted.
- The trainer distributes a list of multiple-choice questions and a scorecard to learners before the training program.
- Trainers are responsible for collecting the completed scorecards by the due date.
- The trainer confirms the learners who achieve the passing mark.
- The trainer confirms the other learners to retake the refresher before attending the class.

Sample
Appendix 6 - Sample – Refresher on Module 3

(3)Pre-Class Preparation on Simulation Case for Assessment on Module 3 Submodule 2

Note to trainers: (1) Appendix 7 contains a sample simulation case on negotiation skills. The Training Package recommends using the case in assessment. (2) Since the learners are to study the case before class and complete the required templates, the case is also a pre-class learning activity.

Objective of this Suggested Learning Activity

This learning activity enables learners to develop and refine their consultation, presentation, and negotiation strategies. It is a two-step learning and assessment process: first, learners prepare their negotiation tactic before class, and then, as a second step, they apply it during the in-class skill assessment.

Suggested Administering Process

- This is an in-class learning and assessment activity with pre-class preparation.
- Trainers are encouraged to create a simulation case focused on either consultation, presentation, or negotiation. For reference resources, trainers can refer to the sample below.

Step 1: Before class

- The trainer instructs learners to read the assessment case and complete pre-class preparation with the provided templates.

Step 2: In-class

- Trainers follow the assessment guide in Section F3 to instruct learners to submit the deliverables completed in Step 1.
- Trainers then follow the assessment guide to instruct the learners to complete Step 2 to assess their skills with negotiation dialogues.
- Aggregated deliverables scores in Steps 1 and 2 form the assessment outcomes of Module 3 Submodule 2.
- Trainers can find detailed guidelines for this case-based assessment in Section F3.

Sample

- A 47-page sample is found in Appendix 7-Sample-Simulation Case (2)-For Assessment.
- The analytical template developed for the above case sample is found in Appendix 10A–Sample Checklist of Negotiation Skills–Simulation Case (2)-For Assessment.

Sources of Materials

Users may consider adopting publicly known cases with much verified information in the public domains. The Users may use the actual non-financial listed companies in the post-class case study.

(4)Post-Class Simulation Case

Objective of the Suggested Learning Activity

The learner integrates adequate knowledge, applications, and behaviours acquired from self-study and class to complete the case.

Suggested Administering Process

Before the completion of a class on a submodule

- The trainer sends an engagement letter attached with simulation case.

Three weeks after class completion of the submodule

- The learner completes the simulation case and sends it to the trainer.

Four weeks after class completion of the submodule

- The trainer sends the completed "Simulation Case Feedback Form" to the learners.
- Each learner registers and sends the completed "Learning Progress Registration Card" to the trainer as evidence of having completed all learning activities of the submodule.
- The trainer files the completed "Learning Progress Registration Card" and the "Simulation Case Feedback Form" as evidence of the learners' completion of all the learning activities of the submodules.
- The trainer may arrange online meetings for each learner to conduct 10 – 15-minute presentation with a subsequent 10 – 15 minutes Q&A session by the trainer and other learners to ensure that the executive report is the learner's own work.
- Each learner registers the completion of this learning activity on the learning progress registration card. Learners are encouraged to brief the direct supervisors/named delegate about completing the learning activities.

Sample

- A 2-page sample letter with simulation case feedback form is provided on the following pages.
- A 18-page sample simulation case is provided in Appendix 4.

Sources of Materials

For Modules 1, 2, and 3, the Users may consider adopting publicly known cases with much verified information in the public domains. Additionally for Module 2, the Users may use the actual non-financial listed companies in the post-class case study. These resources facilitate learners' understanding and discovering of the applicability and limitations of financial ratio analysis in the real-life situation.

<u>Sample (Page 1) – Engagement letter to Learners</u>
<u>Module 1 submodule 1 – Early Warning Signal</u>

[Date]

Dear [name of the learner],

Thank you for your keen effort on the ECF-CRM learning journey. You will find, together with this letter, the simulation case background for your preparation of an executive report, to be completed within the required timeline as a post-class practice on the knowledge acquired in the submodule [Early Warning Signal]. Satisfactory completion of the executive report will show that you possess the competency to achieve the intended learning outcomes below:

(1)	(2)	(3)
Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring	Understand the credit strategy and portfolio objectives of the bank in order to identify the crucial areas for monitoring	Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt remedial actions
(4)	**(5)**	**(6)**
Identify the sources and causes of the changes in risk level, e.g., underwriting, standards, economic conditions, personnel issue and recommend	Demonstrate professionalism by applying impartial and unbiased judgment throughout the loan portfolio assessment process	Monitor and ensure credit administration in compliance with contractual requirements and facility terms
(7)	**(8)**	**(9)**
Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios	Regularly review the advantages and weakness of forecasting, and reviewing approaches and adopt the most reliable measures	Report to senior management about the results of analysis on risk profile of overall loan portfolio

The table below shows the required completion timeline

Date	Learner's Action
[Date: Three weeks after completion of the class on]	Complete and submit the executive report to the trainer together with information on the logged hours to complete the case
[Date: Four weeks after completion of the class]	Send the completed "Learning progress registration card" to the trainer, as evidence of having completed all learning activities of the submodule. Receive the feedback form from the trainer.

Please note that you may be invited to conduct a 10 to 15 minutes presentation on your executive report.

Thank you very much for your enthusiastic support again.

[Signature and title]
cc: learners *[Page 1]*

<u>Sample (Page 2) – Simulation Case Feedback Form</u>
<u>UoC Required Performance Outcomes</u>
<u>Module 1 submodule 1 – Early Warning Signal</u>

Note to trainers:
The learner has completed the classroom training on [name of the submodule]. Please score the specific performance outcomes (listed in the table below) of the learner based on the completed simulation case.

Instructions:
- Please answer the top-of-mind response
- Put a tick in the box that is most representative of the learner at this point in time

Required Performance Outcomes	5	4	3	2	1
Monitoring of portfolio – theory and practices					
• Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring					
• Understand the credit strategies and portfolio objectives of the bank in order to identify crucial areas for monitoring					
• Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt remedial actions					
• Identify the sources and causes of the changes in risk level, e.g., underwriting standards, economic conditions, personnel issue and recommend					
• Demonstrate professionalism by applying impartial and unbiased judgment throughout the loan portfolio assessment process					
Identify credit indicators – account and portfolio					
• Monitor and ensure credit administration in compliance with contractual requirements and facility terms					
• Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios					
Identify relationship between risk level of risk level change and loan provision					
• Regularly review the advantage and weakness of forecasting, and reviewing approaches and adopt the most reliable measures					
Identify key regulations, report remedy to management and make recommendations					
• Report to senior management about the results of analysis on risk profile of overall loan portfolio.					

Number of hours logged to complete the simulation case: ______________ hours (at least 21 hours)
Initial and name of the trainer: ____dated ______

5: The learner’s specific performance outcomes: outstanding
4: The learner’s specific performance outcomes: above average
3: The learner’s specific performance outcomes: largely meet the basic requirements
2: The learner’s specific performance outcomes: inadequately prepared
1: The learner’s specific performance outcomes: not applicable in the selected simulation case

[Page 2]

7.4 Source Materials for In-Class Learning Activities

7.4.1 Sources of Cases for Newsroom

The ice-breaking interactive session sensitizes learners within the 15-minute interactive time on the importance of the competency relevant for Modules 1, 2 or 3.

Potential sources of cases/information

- Experience of trainers
- Experience of learners
- Credible sources such as research and speeches from governments and international organizations
  Sample link:
  e.g., Bank for International Settlements (bis.org)

Potential case examples of risk appetite conception and statements

- Most of the banks include in their annual reports description of the principles guiding their risk appetite, and a few banks publish the risk appetite conception process and the description of their risk appetite, serving good reference for trainers.

Potential case examples of sovereign risk

- 1980 & the 1990s – Emerging market crises in Argentina, Brazil, and Mexico
- 2008 - the global crisis
- 2010 - euro area crisis

Sample links:
Sovereign Debt and Financial Crises: An Historical Analysis - IMF F&D Magazine

Potential case examples of systemic risk

- The 1990s – Asian Financial Crisis
- BIS.ORG Research and Publication No. 52 on market changes before and after the financial crisis

Sample links:
Hong Kong Monetary Authority - The Asian Financial Crisis: What Have We Learnt? (hkma.gov.hk)
Hong Kong Monetary Authority - The Asian Crisis: Lessons for the Future (hkma.gov.hk)
Credit Risk During the Asian Crisis (hkma.gov.hk)
qbsp03e.pdf (hkma.gov.hk)
A framework to monitor vulnerabilities and resilience of EMEAP economies (hkma.gov.hk)

Potential case examples of specific industry risk

Sample links:
Aviation industry: 1160 Active Aircraft: Which Airlines Fly The Most Boeing 737 MAX? (simpleflying.com)
Real estate industry: China Accuses Evergrande of $78 Billion Fraud, Worse Than Luckin and Enron - Bloomberg

Potential case examples of ESG/sustainable/climate financing risk

Sample links:
Deconstructing ESG scores: how to invest with your own criteria (bis.org)
UBS Banker's Comments Highlight Challenges Facing Green Banking - Bloomberg

7.4.2 Sources of Interactive Learning (lecture)

Potential sources of materials

- Experience of trainers
- Experience of learners
- Credible sources such as research and speeches from governments and international organizations
  Sample link:
  e.g., Bank for International Settlements (bis.org)
- Sources highlighted in the above session Newsroom
- Section G1, G2 and G3 of the Training Package also provides potential reference materials

7.4.3 Potential List on Sharing Topics in the Seminar on Updates and Case Experience on Operational Risk and Regulatory Risk relevant to Modules 1, 2 and 3.

Potential seminar topics for invited guest speakers to share topics on:

Operational and regulatory risk for one or several of the following topics in each 60-minute seminar (sharing live issues attracting high level of attention):

- Key regulations
- Case related to credit operational risk
- Loan classification
- Capital adequacy and provisioning
- Collateral authentication
- Stress testing design overview
- Contingency plan overview
- ESG financing overview

More of the relevant topics for the trainer's consideration:

- Project finance overview
- Special industry financing overview
- Commodity financing overview
- Start-up technology company- financing overview

7.5 Learning Facilities Suggested

Suggested learning facilities are listed in the following table:

Classroom set up	For trainers	For learners
Laptop (Qty: 1 pcs) Projector (Qty: 1 pcs) Screen/Wall for Projection Flip Chart (Qty: 2 pcs) Flip Chart Paper (Qty: 50 pcs) A4 Size Blank Paper (Qty: 50 pcs) Colour Pens for Flip Chart (Qty: 6) Optional candies/drinks	Bring along lap-top	Bring along lap-top for - Economic, industry, and company information retrieved from the internet - Assessing data from the internet if internet links provided in the assessment questions - Assessing necessary information for responding to short and long questions - For written response on MCQ, short and long questions.

F. ASSESSMENT GUIDE

This section describes the assessment activities and methods to facilitate the collection of evidence and assess whether the learner has applied the competencies required in the context of workplace requirements, as prescribed in the assessment criteria of related UoC.

The assessments take place in class to allow learners to share and learn from their peer learners.

1 Mapping with ILO and Assessment Methods

Written assessment activity is recommended for the Module 1:

Mode	Assessment Methods	% Contribution to programme assessment	ILO				
			Submodule 1	Submodule 2	Submodule 3	Submodule 4	Submodule 5
Class	Written assessment - Short questions	20%	X	X	X	X	X
	Written assessment - Long question	40%	X	X	X	X	X
	Written assessment - One case-based interactive question for Module 1	40%	X				

Written assessment activity is recommended for the Module 2:

Mode	Assessment Methods	% Contribution to programme assessment	ILO		
			Submodule 1	Submodule 2	Submodule 3
Class	Written assessment - Short questions	20%	X	X	X
	Written assessment - Long question	40%	X	X	X
	Written assessment - One case-based interactive question for Module 2	40%	X		

Written and interactive assessment activity is recommended for Module 3

Mode	Assessment Methods	% Contribution to programme assessment	ILO	
			Submodule 1	Submodule 2
Class	Written assessment - Short questions	20%	X	X
	Written assessment - Long question	40%	X	X
	Written and interactive assessment - One case-based interactive questions for Module 3	40%	X	

2 Assessment Activities and Tools

The table below provides some suggested assessment activities for Modules 1, 2, and 3. The assessment with short questions and long question takes place at the end of each submodule in the class. The assessment with case-based question takes place at the end of each module.

Assessment Method	Assessment Activities	Deliverables of the Assessment Activities	Scored by	Assessment Time
Continuous: written assessment for each submodule	Short questions	The learner completes three short questions	Trainer/ assessor	60 minutes
	Long question	The learner completes one long question composed of several related short questions	Trainer/ assessor	90 Minutes
Final: written assessment for each Module	Case-based question	At the end of each Module, the learner completes one set of case-based questions that demand integration of knowledge, applications, and behaviours in one of the submodules.	Supervisor/ named delegate/ delegated approver	90 minutes

3 Assessment Objective, Administering Process and Samples

3.1 Assessment Objective

Learners are expected to be able to achieve the required performance outcomes after completing the learning programme. Through assessment tasks, the learners would be able to demonstrate that they can integrate and apply their learning to different situations.

3.2 Administering Process and Samples

To facilitate learners' performance outcomes at QF Level 5, the trainer should design assessments based on practical commercial banking scenarios and context.

3.2.1 Assessment with short questions

Suggested administering process:

Step 1: Before the Assessment

- The trainer instructs the learners to create their word documents for the answers and put the following information at the beginning of the word documents:
    - Name
    - Question-number
- The trainer gives the learners 10 minutes to complete one question individually
- The trainer then goes to Step 2

Step 2: Learners Sharing Views

- Each learner teams up with one other learner to discuss the answers for 5 minutes
- Then, the trainer facilitates in-class group-sharing for 5 minutes
- After the group sharing, the trainer requests the learners to complete another question repeating Step 1
- The trainer repeats Step 2 until the learners complete all three questions.

Step 3: After the Assessment

- The trainer requests learners to submit the answers to a designated email address
- The trainer scores the answers of the individual learners against the pre-set answers
- The learners get marks for answers that are similar in meaning and context to the pre-set answers
- The trainer registers the scores of the assessment

Sample

Sample questions and response plans are provided after the explanation on the short questions.

Explanation of the sample short questions and learning points

Explanation

- The questions help learners apply the knowledge and skills obtained in class and the workplace, for example:
  - Experience with borrowers, supervisors, and working peers
  - Knowledge acquired from team, department, bank meetings
  - Knowledge extracted from interactions with the industry networks

Learning points

- The three short questions can be unrelated to one another, with different learning points. For instance:

  - Sample 1 below focuses on the identification of the early warning signals concentrating on data from internal processes with compliance of requirement, whereas:
  - Sample 2 below focuses on identifying the early warning signals concentrating on data from external information collection and the subsequent recommendation of risk remedial actions.

The learner may respond to the questions with a plan demonstrating his achievement in terms of ILO listed in Part (E) 1.1.1

Sample 1
Assessment with Short Question
Module 1 submodule 1 – Early Warning Signal

Question	Time Allowed	Question
1	- Total: 20 min - Individual working: 10 min - Team discussion: 5 min - Group sharing: 5 min	**"Early warning signals help management make adequate, timely decisions to lower potential credit losses and capital requirements by identifying opportunities to rebalance portfolio risk level and improve asset quality before a possible default event."** **Question:** In credit risk management of commercial mortgage portfolio, what is the significance of credit risk administration functions in identifying early warning signals?

Debrief of the Short Question: Suggested response plan, answer checklist and assessment rubrics:

Content			
Monitor portfolio - theory and practice	**Identify early warning signals**	**Identify the relationship of the risk level change with loan provision**	**Identify regulations, report remedy and make recommendations**
Response plan to demonstrate selected performance requirements			
- Identify the most appropriate method in risk monitoring - Identify the crucial area for monitoring	- Identify early signals of delinquency or system risk - Identify sources and causes of the changes in risk level - Apply impartial and unbiased judgment	- Review advantages/ weaknesses of forecast, review approach - Adopt the most reliable measure	- Report to senior management about the results of analysis on risk profile of overall loan portfolio
Response			
Example - Can quote from HKMA SPM CR-G-3[7] - Banks should have adequate processes to ensure the designated departments complete timely and effective administration of all credit risk-bearing portfolios.	**Example** - Deviation of LTV ratio from targets/norms of commercial mortgage loan portfolios can be an early warning signal - The variation can be caused by systematic risk changes. Sources and causes of the changes should be identified - Perform additional analysis on historic LTV of relevant customers and economic sectors to form an unbiased judgment of the early warning signals	**Example** - Check whether the changes in risk indicators are in line with the forecast and review - Estimate if the changes are temporary or for an extended period - Estimate the impact on loan provision after the formation of an unbiased judgment on the changes in probability of default	**Example** - Credit administration has regular reporting fulfillment enabling senior management. - For significant early warning signals, report immediately to senior management the analysis and recommendation
1 point per bullet	**1 point per bullet**	**1 point per bullet**	**1 point per bullet**
	Maximum Points	**7 points**	

[7] Refer to Section G Subsection 3.1 to access CR-G-3 Credit Administration, Measurement and Monitoring

Sample 2
Assessment with Short Questions
Module 1 submodule 1 – Early Warning Signal

Question	Time Allowed	Question
2	- Total: 20 min - Individual working: 10 min - Team discussion: 5 min - Group sharing: 5 min	**"Early warning signals help management make adequate, timely decisions to lower potential credit losses and capital requirements by identifying opportunities to rebalance portfolio risk level and improve asset quality before a possible default event."** **Question:** What is system risk? Discuss the credit risk inherent in the entire portfolio. Please explain its relevance in identifying early warning signals of the portfolio. What are the possible remedial actions on a portfolio releasing warning signals?

Debrief of the Short Question: Suggested response plan, answer checklist and assessment rubrics:

Content			
Monitor portfolio – theory and practice	**Identify early warning signals**	**Identify the relationship of the risk level change with loan provision**	**Identify regulations, report remedy and make recommendations**
Response plan to demonstrate selected performance requirements			
- Identify the most appropriate method in risk monitoring - Identify the crucial area for monitoring	- Identify early signals of delinquency or system risk - Identify sources and causes of the changes in risk level - Apply impartial and unbiased judgment	- Review advantages/ weaknesses of forecast, review approach - Adopt the most reliable measure	- Report to senior management about the results of analysis on risk profile of overall loan portfolio
Response			
Example - Banks should have a team to conduct periodical environment scanning to identify changes in external risk factors - RPs should fully deploy industry networks to validate suspected changes in risk factors.	**Example** - System risk is a risk inherent in the entire portfolio. - It sparks risk events that can lead to collapse of some industries - Example: default of creditors on sub-prime mortgage causing the collapse in the sub-prime market, triggering the massive decrease of Lehman Brother's portfolio values, sending shock waves in the global financial markets	**Example** - System risk is complex and its early warning signals are difficult to perceive - Example: black swan events which no one has forecasted their happenings - Even continuous assessment of the external risk factors may be inadequate to shelter against systemic risk	**Example** - Report the outcomes of the check and balance exercise to identify the trade-off of lowered risk tolerance, revenue and client relation with large borrowers - Recommend lowering the risk alert level on focused products, borrowers, segments, and industries
1 point per bullet	**1 point per bullet**	**1 point per bullet**	**1 point per bullet**
	Maximum Points	**7 points**	

3.2.2 Assessment with long questions

Suggested administering process:

Step 1: Before the Assessment

- The trainer instructs learners to create their word documents for the answers and put the following information at the beginning of the word documents:
  - Name
  - Question-number
- Learners are allowed to go to internet for more relevant information
- The trainer reminds learners to organize responses in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and evaluate real-life applications supported by examples.
- The trainer gives the learners 60 minutes to complete one long question individually
- After 60 minutes, the trainer goes to Step 2

Step 2: Group Sharing Views

- The trainer requests learners to submit the answers to a designated email address
- Then, the trainer facilitates class-sharing for 30 minutes

Step 3: After the Assessment

- The trainer scores the answers of the individual learners against the pre-set answers.
- The learners get maximum marks for answers that are similar in meaning and context to the pre-set answers and organized in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and evaluate real-life applications supported by examples.
- The trainer registers the scores of the assessment.

  .

Sample

A sample question and its response plan are provided after the explanation of the long question.

Explanation of the sample long question and learning points

Explanation

- There is one long question for each submodule
- The question helps learners apply the knowledge and skills obtained in class and the workplace, for example
  - Experience with borrowers, supervisors, and working peers
  - Knowledge acquired from team-, department- and bank-meetings
  - Knowledge extracted from interactions with the industry networks
- The learners should present the total solution
- A long question consists of five sub-questions, all related to one situation

Learning points

- The learners would become aware that how, in real work environment, collecting data and information during risk signal identification is the initial step leading to identifying sources and causes of key risk drivers and subsequent unbiased judgments for continual risk signal identification.

Sample
Assessment with Long Question
Module 1 submodule 1 – Early Warning Signal

Corporate finance theory states that **"Enterprises must be able to make timely judgments according to the macroeconomic situation and adjust their financial behavioural, such as reducing investment and cost, to preserve cash flow and decrease the risks of falling into financial distress. "However**, different enterprises have a varied judgment on risk, cash flow management, and financial risk, especially under unforeseen system events. Hence, the risk level of various enterprises is impacted by unforeseen system events to different degrees, from slightly affected to moderately or significantly impacted.

Optional Reading
Does Economic Policy Uncertainty Exacerbate Corporate financial distress risk? Jie Sun, Fangyuan Yin, Edward Altman and Lewis Makosa, Journal of Credit Risk 17(4), 71-99, DOI:10.21314/JCR/2021/013

Note to learners: Please organize responses in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and to evaluate real-life applications supported by examples.

Credit Management Context
With the unforeseen pandemic outbreak since 2020, the environment scan shows warning indicators that the property markets may face a cyclical downturn in the short to medium term. Moreover, the pandemic now continues into its second[8] year. Therefore, you are reviewing the property development sector's portfolio credit risk indicators.

Task 1 (8 points)
- Indicate the credit risk indicators that banks use to monitor the credit portfolio quality
- Elaborate on the purpose of tracking these risk indicators
- For each credit risk indicator, please state the threshold change (e.g., unchanged, raise acceptance criteria, or lower acceptance criteria) in the past 12 months and the rationale for the changes, if applicable.

Task 2 (8 points)
- How do you ensure that the credit administration is carried out diligently? Please share some examples of your day-to-day experience.

Task 3 (8 points)
- Why is it essential for RPs to sensitize about borrowers' fulfilling contractual terms and conditions, and keep monitoring continuously?

Task 4 (8 points)
- Elaborate on the potential causes and sources for changes for the risk indicators identified in Task 1, e.g., underwriting standards, economic conditions, and personnel issues, focused on the loans to property developers.

Task 5 (8 points)
- While you continually monitor the risk characteristics of the loan portfolio, how are you sure about having applied impartial and unbiased judgment to identify early warning signals?

Optional Reading on prudential measure on non-residential mortgage loans. Prudential Measures for Mortgage Loans on Non-residential Properties (hkma.gov.hk)…

[8] This is the context of the question

Response Plan

Content	ILO	Task	Response Example	Assessment Rubrics
Monito portfolio – theory	- Identify the most appropriate method in risk monitoring - Identify crucial areas for monitoring	5	To make an adequate judgment to identify crucial monitoring areas and to identify adequate methods: - Understand the bank's risk appetite and business strategy (e.g., attend all of the bank's meetings) - Read updates on economic conditions (e.g., in-house economist reports, government, and 3rd party research reports) - Read updates on industries (e.g., read industries' research, join industry seminars, follow updates on regulatory changes. - Periodic updates (e.g., read financials of the concerned sectors, business cycles of the concerned industries, make appointments with owners/ executives of the concerned industries to get more information) - Conduct sharing at department meetings	**Maximum** 2 points per bullet **Maximum points**: 8
Monitor portfolio - practices	- Identify early signals of delinquency or system risk - Identify the sources and causes of the changes in risk level - Exercise impartial and unbiased judgment	4	To have impartial and unbiased judgement to identify the sources and causes: - Monitor economic conditions e.g., GDP growth - Monitor geographical conditions e.g., whether deteriorating market conditions have a contagious effect on the similar market in the banks' target markets - Monitor stage changes of the industry cycle e.g., more prudent judgment for rapid growth or rapid decline stage - Inherent conditions in significant borrowers e.g., whether borrowers' businesses are highly concentrated without diversified income sources e.g., whether the	**Maximum** 2 points per bullet **Maximum points**: 8

			borrowers' businesses are highly dependent on big players in the concerned market e.g., whether the borrowers have the financial strength to shelter against a decline of the industry cycle e.g., whether the borrowers' credit qualities are still satisfactory	
Identify early warning signal	- Monitor and ensure credit administration in compliance with contractual requirements and facility terms	1	- Monitoring of compliance with contractual requirements and facility terms will identify default situations e.g., default occurs when terms are not fulfilled but not necessarily non-payment e.g., liquidity shortage to make timely payment e.g., strategic non-payment by the borrowers - Continuous monitoring of individual accounts reveals non-compliance cases for aggregation to reflect the portfolio situation. e.g., credit indicators by loan type, by geographic locations, by debt servicing ratio, by secured or non-secured types - Continuous monitoring of the contagious effect of the concerned portfolio on the other portfolios - Continuous monitoring of the changes in the risk alert threshold	**Maximum** 2 points per bullet **Maximum points**: 8
Identify the relationship of risk level change with loan provision	- Review advantages/ weaknesses of forecast, review approach and adopt the most reliable measure	3	- The technology advancement enables the application of more sophisticated and timely computation of portfolio risk levels. However, the inputs for the model parameters are mostly assumption-based - Since all forecasting models, applied with statistical assumptions or judgmental assumptions, need periodic improvements, continuous monitoring becomes a	**Maximum** 2 points per bullet **Maximum points**: 8

			compensating measure to identify early warning signals - The management reads the reports on early warning signals and makes a judgment call to fine-tune credit guidelines that may affect the intake of new businesses of exact nature and others and whether the portfolio ratings are to be reviewed and fine-tuned accordingly - As a prudent management measure, the changes in the portfolio risk levels have a consequential impact on loan provisioning	
Identify key regulations, report remedy, and make recommend-dation	- Report to senior management about the results of analysis on risk profile of overall loan portfolio	2	- Individual account credit risk changes measured with various indicators (e.g., non-compliance with control terms, delinquency, changes in market values, loan to value, debt servicing ratio, secured or non-secured portfolio percentage) would be aggregated and reported - The report should provide alerts at several levels, and there should be a pre-set response to each alert level - The insights generated by the analysis by credit administration power add value to the report at the senior management level - The insights generated by the analysis should form the foundation for periodic changes in the risk modeling assumption change to form a complete credit risk management feedback cycle	**Maximum** 2 points per bullet **Maximum points**: 8
			Maximum	**40 points**

3.2.3 Assessment with case-based interactive question

Suggested administering process:

Step 1: Before the Assessment

- The trainer instructs learners to create their word documents for the answers
- The trainer instructs learners to put necessary information at the beginning of their own word document:
    - o Learner's name
    - o Question-number
- The trainer reminds learners to organize responses in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and evaluate real-life applications supported by examples.
- The trainer reminds learners that they have 90 minutes to complete the question individually
- The trainer reminds learners that they may also refer to public information on internet
- After 90 minutes, the trainer goes to Step (2)

Step 2: Group Sharing

- The trainer requests learners to submit the answers to a designated email address
- Then, the trainer facilitates class-sharing for 60 minutes, at trainer's discretion

Step 3: After the Assessment

- The trainer scores the answers of the individual learners against the pre-set answers
- The learners get maximum marks for answers that are similar in meaning and context to the pre-set answers organized in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and evaluate real-life applications supported by examples.
- The trainer registers the scores of the assessment

Sample

A sample question and its response plan are provided after the explanation of the case-based interactive question.

Explanation of sample case-based interactive Questions and learning points

Explanation

- Sample below is provided for the Users to design assessment at the end of Modules 1, 2 and 3.

- Users may select several ILO to compile the case-based questions so that learners can integrate knowledge and skills to complete the response to the specific questions within 90 minutes.

- The response format is consistent with the assessment using short and long questions. The learners refer to the limited information provided and respond to the questions with ingredients of similar cases from the live experience or the publicly available knowledge.

- Learners will go through one case-based interactive question upon completing all sub-modules in each Module.

- For Modules 1, 2 and 3, the Users may consider adapting publicly known cases with much information in the public domains. The Users may adapt the financial figures in the listed non-financial companies. These resources facilitate learners' understanding and discovery of the applicability and limitations of financial ratio analysis in a real-life situation.

Learning points

- A learner performs a 360 degree inside-out identification of early warning signals, only to find out that risk signals could be inconsistent with different data sources and time frames. The learners will become aware of the necessity to broaden the horizons on identification of early warning signals.

SAMPLE

Sample: Case-Based Interactive Question
Module 1 (Based on Submodule 1) Early Warning Signal

The learner may respond to the questions with a plan demonstrating his achievement in terms of ILO listed in Part (E) 1.1.1

Case-Based Question

Part (1) Note to Learners

1. Learners may supplement the information provided in the case outline with private and public research of the related macro-economic, industry, and company information.

2. The nature, size, and complexity of each bank's portfolios vary. The learners will apply their banks' practices for the recommended actions.

3. Learners have 90 minutes to complete a case-based question. The response should be put on a word document. The answers should be submitted to a designated email address.

Part (2) Declaration
The following is a hypothetical case.

Part (3) Client's Background
Company A is a Mainland property real estate company that constructs residential and commercial properties on the mainland while investing actively in the overseas property market. It is NOT your bank's customer.

- **Founded** – 1990s

- **Fast Growing –** Like many other companies riding on the mainland's economic boom in the past 20 years, it's a fast-growing company.

- **Heavily Indebted –** Company A was recently known as the most debt-bearing developer with its USD300 billion financial obligations.

Part (4) Recent Deterioration in Financial Strength

On news headline – Company A has recently been spotlighted in the financial section of the newspapers. In addition, there have been rumors about its debt repayment capability for some time. There was first default recently.

Root Causes - People cited various reasons for the deterioration of the financial situation, including the Beijing policy change to curb property prices. There are blames such as poor management and reckless expansion. It seemed to the public that the authority was not likely to bail out the Company.

Part (5) Interim Financial Statements as of Dec 2021

Trainers may provide an internet link or Dropbox link for easy retrieval of information on the financial statements for the simulated case. The sample on Page 104 demonstrates one of the schedules compiled by learners.

Part (6) You have an Assignment

It is now August 25, 2021, and there has been continuous development regarding Company A's situation, which has caused the market's attention with its possible enormous potential impact on the mainland, the economic sector, and the related industries. You are an RP in a commercial bank. Your supervisor has informed you that you have become a member of a dedicated sub-committee. Each team member handles different tasks.

Part (7) Your Mission

The bank's portfolio contains similar clients of the same sector, though with different scales. As a Task Force member, you will be responsible for delivering specific tasks (1) to (4) and, based on that, make suggestions that the sub-committee leader will integrate into the recommendation list for senior management's consideration.

The Senior Management wants the individual designated Task Force member to demonstrate competency in knowledge, skills, and behaviours with the deliverables from (1) to (4).

With the outcomes from Task (1) to (4), you can support the recommendations requested in Task (5), which you may further support with rationales, such as financial and root cause analysis.

The recommendations should contain the following actions:

- Immediate remedial actions
- Immediate monitoring measures
- Follow-up actions
- Update credit risk objectives
- Update of policy, guide, and standards
- Update of risk management strategies

Note to learners: Please organize response in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and to evaluate real-life applications supported by examples

Task Number	Assessment on	Deliverables	Points
1	Monitor portfolio – theory and practice	Compare business performance over the years. Part (i) Complete a spreadsheet to compare financial data for three or more years. Part (ii) Comment on three significant trends as an early warning signal	**Maximum** 4 points **Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
2	Monitor portfolio – theory and practice	Analyse the relationship between profit, share price, and credit rating of Company A. Part (i) Compute a graph with three variables of net profit, share price, and credit rating Part (ii) Make three observations relevant to the identification of an early warning signal.	**Maximum** 4 points **Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
3	Identify early warning signal	During COVID19, cross-border travel came to a halt. On-site visits are impossible. Part (i) Based on the raw data provided, prepare an inventory of Company A's construction sites Part (ii) Suggest three potential early warning signals for the industry.	**Maximum** 4 points **Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
4	Identify early warning signals	Analyse external environment, industry situation and internal management factors. Part (i) Analyse the root causes leading to the credit default of A Company. Part (ii) Will the above causes remain "permanent," and that loan classification need to be reconsidered if Company A is one of your clients?	**Maximum** 4 points **Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
5	Make recommendations	From analysis drawn from Task (1) to Task (4), Part (i) Summarize lessons learned Part (ii) Make recommendations in the following areas: - Immediate remedial actions - Immediate monitoring measures - Follow up actions - Update of credit risk objectives - Update of policy, guide, and standards	 **Maximum** 4 points **Maximum** 4 points

Consolidated Statement of Profit or Loss and Other Comprehensive Income

	2014	%	2015	%	2016	%	2017	%	2018	%	2019	%	2020	%
Amount expressed in billions	$		$		$		$		$		$		$	
Revenue														
Sales of properties	107.5		126.4		203.9		302.4		452.8		464.6		494.6	
Rental income	0.1	100%	0.2	100%	0.6	100%	0.8	100%	1.2	100%	1.4	100%	1.3	100%
Property management services	1.3		1.3		1.9		3.0		4.1		4.4		6.6	
Other businesses	2.5		5.1		5.0		4.8		8.2		7.3		4.9	
less: Cost of sales	-79.6	-71%	-95.7	-72%	-152.0	-72%	-198.8	-64%	-297.2	-64%	-344.6	-72%	-384.6	-76%
Gross profit	31.8	29%	37.4	28%	59.4	28%	112.3	36%	168.9	36%	132.9	28%	122.6	24%
Fair value gains on investment properties	9.4	8%	12.9	10%	5.1	2%	8.5	3%	1.3	0%	1.5	0%	1.3	0%
Impairment losses on financial assets	0.0	0%	0.0	0%	0.0	0%	0.0	0%	-0.1	0%	-0.2	0%	-0.3	0%
(Loss)/gain on disposal of subsidiaries	0.7	1%	0.0	0%	6.6	3%	0.0	0%	2.2	0%	1.1	0%	-0.2	0%
(Loss)/gain on disposal of joint ventures and associates	0.0	0%	0.0	0%	0.3	0%	0.1	0%	-0.1	0%	0.0	0%	0.3	0%
(Loss)/gain on disposal of available-for-sale financial assets	-0.2	0%	0.3	0%	0.0	0%	-7.2	-2%	0.0	0%	0.0	0%	0.0	0%
Net foreign exchange gains and others	0.0	0%	0.0	0%	0.0	0%	1.0	0%	0.6	0%	0.6	0%	-1.7	0%
Losses in relation to the restructions of Strategic Investors' equity interest in a subsidiary	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	-3.5	-1%
Interest income	0.3	0%	1.0	1%	3.7	2%	4.1	1%	3.9	1%	4.6	1%	5.7	1%
Forfeited customer deposits	0.0	0%	0.2	0%	0.4	0%	0.6	0%	0.8	0%	0.9	0%	1.4	0%
Gain on disposal of investment properties	0.3	0%	0.2	0%	0.4	0%	0.2	0%	0.1	0%	0.1	0%	0.6	0%
Dividend income of FVOCI	0.2	0%	0.0	0%	0.1	0%	0.4	0%	0.3	0%	0.0	0%	0.0	0%
Management and consulting service income	0.0	0%	0.0	0%	0.0	0%	0.0	0%	1.1	0%	0.6	0%	1.8	0%
Others	0.6	1%	0.8	1%	0.3	0%	0.3	0%	0.5	0%	0.8	0%	0.8	0%
Selling and marketing costs	-9.2	-8%	-13.3	-10%	-16.0	-8%	-17.2	-6%	-18.1	-4%	-23.3	-5%	-32.0	-6%
Administrative expenses	-4.0	-4%	-6.1	-5%	-9.6	-5%	-12.2	-4%	-14.8	-3%	-19.8	-4%	-21.1	-4%
Other operating expenses	-1.4	-1%	-1.1	-1%	-2.7	-1%	-5.6	-2%	-5.2	-1%	-5.0	-1%	-6.1	-1%
Profit/(Loss) from operation	28.6	26%	32.3	24%	48.2	23%	85.2	27%	141.4	30%	94.9	20%	69.7	14%
Fair value gain/(loss) on financial assets at fair value through profit or loss	3.8	3%	2.5	2%	0.1	0%	-0.4	0%	0.1	0%	-1.9	0%	0.0	0%
Fair value gain/(loss) on derivative financial liabilities	0.0	0%	0.0	0%	0.0	0%	-0.8	0%	0.8	0%	1.0	0%	2.2	0%
Interest expenses														
Bank and other borrowings	-12.0	-11%	-17.8	-13%	-26.1	-12%	-44.4	-14%	-48.4	-10%	-51.4	-11%	-58.5	-12%
Senior notes	-1.7	-2%	-1.5	-1%	-2.0	-1%	-4.5	-1%	-5.1	-1%	-11.9	-2%	-19.9	-4%
Convertible bonds	0.0	0%	0.0	0%	0.0	0%	0.0	0%	-1.1	0%	-1.4	0%	0.0	0%
PRC bonds	0.0	0%	-0.9	-1%	-3.6	-2%	-3.8	-1%	-3.3	-1%	-3.8	-1%	-3.3	-1%
less: interest capitalised	13.6	12%	20.3	15%	26.3	12%	45.1	14%	49.9	11%	50.9	11%	69.5	14%
Exchange gains/(losses) from borrowings	0.0	0%	-2.8	-2%	-4.9	-2%	1.0	0%	-6.2	-1%	-4.0	-1%	10.3	2%
less: exchange losses capitalised	0.0	0%	0.7	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%
Other finance costs	-1.0	-1%	-0.8	-1%	-1.1	-1%	-1.2	0%	-0.4	0%	-1.2	0%	-0.3	0%
Share of profit/(loss) of associates	-0.1	0%	0.2	0%	0.6	0%	1.2	0%	0.3	0%	4.6	1%	0.4	0%
Share of profit/(loss) of joint ventures	-0.1	0%	-0.6	0%	-0.8	0%	0.2	0%	-1.1	0%	-1.6	0%	-1.8	0%
Profit/(Loss) before taxation	31.2	28%	31.4	24%	36.9	17%	77.5	25%	126.8	27%	74.2	16%	68.2	13%
Income tax expense														
Hong Kong profit tax	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%
PRC corporate income tax	-6.6	-6%	-5.8	-4%	-11.1	-5%	-22.6	-7%	-36.2	-8%	-25.6	-5%	-27.9	-6%
PRC land appreciation tax	-4.2	-4%	-4.5	-3%	-8.4	-4%	-18.8	-6%	-27.3	-6%	-21.1	-4%	-16.7	-3%
Deferred income tax														
PRC corporate income tax	-0.8	-1%	-2.4	-2%	0.7	0%	0.4	0%	2.4	1%	3.8	1%	5.1	1%
PRC land appreciation tax	-1.5	-1%	-1.5	-1%	-0.5	0%	0.7	0%	0.9	0%	2.4	0%	2.7	1%
Profit/(Loss) after taxation	18.0	16%	17.3	13%	17.6	8%	37.0	12%	66.5	14%	33.5	7%	31.4	6%
Other comprehensive income														
Items that may be reclassified to profit or loss:														
Change in value of available-for-sale financial assets, net of tax	0.2	0%	0.0	0%	-3.0	-1%	2.2	1%	0.0	0%	0.0	0%	0.0	0%
Share of other comprehensive income of investments accounted for using the equity meth	0.0	0%	0.0	0%	-2.7	-1%	2.4	1%	0.1	0%	0.0	0%	0.0	0%
Currency translation difference	0.0	0%	0.0	0%	0.8	0%	-0.7	0%	0.5	0%	-0.3	0%	-0.2	0%
Items that may not be reclassified to profit or loss:														
Revaluation gains arising from transfer of construction in progress to investment propertie	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%
Share of other comprehensive income of investments accounted for using equity method	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%	0.0	0%
Change in fair value of financial assets at fair value through other comprehensive income,	0.0	0%	0.0	0%	0.0	0%	0.0	0%	-0.4	0%	0.0	0%	-0.1	0%
Total comprehensive income for the year	18.2	16%	17.4	13%	12.7	6%	40.9	13%	66.7	14%	33.3	7%	31.0	6%
Profit/(Loss) attributable to:														
Shareholders of the Company	12.6		10.5		5.1		24.4		37.4		17.3		8.1	
Holders of perpetual capital instruments	4.3		5.1		0.0		0.0		0.0		0.0		0.0	
Non-controlling interests	1.1		1.8		12.5		12.7		29.2		16.3		23.3	
	18.0		17.3		17.6		37.0		66.5		33.5		31.4	
Total comprehensive income/(loss) attributable to:														
Shareholders of the Company	12.8		10.5		0.2		27.4		37.5		17.1		7.9	
Holders of perpetual capital instruments	4.3		5.1		0.0		0.0		0.0		0.0		0.0	
Non-controlling interests	1.1		1.8		12.5		13.5		29.2		16.2		23.2	
	18.2		17.4		12.7		40.9		66.7		33.3		31.0	

Part (8) Learner's Response Plan

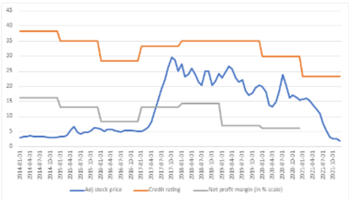
Task Number	Assessment on	Deliverables	Points
1	Monitoring of portfolio – theory and practice	Compare business performance over the years. Part (i) Complete a spreadsheet to compare financial data for three or more years. Part (ii) Comment on three significant trends as an early warning signal	**Maximum** 4 points **Maximum** 4 points

Response Plan

Part (i)	Points	Part (ii)	Points
Comparison of financial statements (See sample consolidated statement of profit and loss)	**Maximum** 4 points	Three significant trends were revealed from financial statement analysis as early warning signals. - Gross profit peaks in 2017 at 36% and drops until 2021 at 24%, lower than the 2010 level. - Profit from operations peaks in 2018 at 30% 2018 and drops until 2021 at a 14% level. - Repay a substantial loan from the provincial government instead of rolling-over.	**Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
2	Monitoring of portfolio – theory and practice	Analyse the relationship between Profit, share price, and credit rating of Company A. Part (i) Compute a graph with three variables of net profit, share price, and credit rating Part (ii) Make three observations relevant to the identification of an early warning signal.	**Maximum** 4 points **Maximum** 4 points

Response Plan

Part (i)	Points	Part (ii)	Points
	**Maximum** 4 points	Three significant observations regarding early warning signals: - In good years (2014 – 2018), credit rating moves in line with profit changes. - In a bad year, the credit rating changes lag behind profit drops - Share price growth rate disproportional to profit growth rate in a good year and remain high despite sustained profit plateau.	**Maximum** 4 points

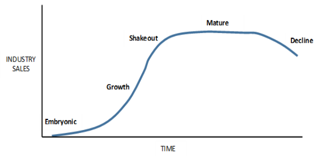
Task Number	Assessment on	Deliverables	Points
3	Identify early warning signal	During COVID19, cross-border travel came to a halt. On-site visits are impossible. Part (i) Based on the raw data provided, prepare an inventory of Company A's construction sites Part (ii) Suggest three potential early warning signals for the industry.	 **Maximum** 4 points **Maximum** 4 points

Response Plan

Part (i)	Points	Part (ii)	Points
[Internet link provided to learners] Company A owns 565 million square meters of development land and real estate project in 22 cities. e.g., Guangzhou e.g., Tianjin e.g., Shenyang e.g., Wuhan etc.	**Maximum** 4 points	One might be able to identify an early warning signal from the actual progress of the financed project - construction progress report - occupancy ratio - property unit price change - construction progress by visual (with help from branch staff on the mainland), etc.	**Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
4	Identify early warning signal	Analyse external environment, industry situation and internal management factors Part (i) Analyse the sources and root causes leading to the credit default of A Company Part (ii) Will the above causes remain "permanent," and thus loan classification needs to be reconsidered if Company A is one of your clients?	 **Maximum** 4 points **Maximum** 4 points

Response Plan

Part (i)	Points	Part (ii)	Points
Trainers may provide relevant Internet information link to the learners; or learners may search internet for relevant information  -	**Maximum** 4 points	A learner might draw a summary with relevant analysis: <u>External factors</u> The economic growth rate of A company's primary market shrinks continuously <u>Industry factors</u> The construction rate is faster than the purchase by the market <u>Internal factors</u> Company A paid a significant amount of cash dividends. The company issued bonds at high rates to finance the construction projects	**Maximum** 4 points

Task Number	Assessment on	Deliverables	Points
5	Make recommendations	From analysis drawn from Task (1) to Task (4), Part (i) Summarize lessons learned Part (ii) Make recommendations in the following areas: - Immediate Remedial actions - Immediate monitoring measures - Follow up actions - Update of credit risk objectives - Update of policy, guide, and standards	 **Maximum** 4 points **Maximum** 4 points

Response Plan

Part (i)	Points	Part (ii)	Points
- The learner draws lessons learned: - A listed company's disclosure in the annual reports might not contain all the necessary information for a thorough credit risk analysis. - The visible deterioration in a customer's financial status might be much harder to identify than the visual deterioration of the market environment. - The special purpose vehicles could have masked significant financial transactions.	**Maximum** 4 points	Immediate remedial actions - Review the trend of credit indicators for similar portfolios - Review the trend of credit indicators at account levels - Review the trend of credit indicators at counterparty levels - Immediate monitoring measures - Set a lower alert level for management to review the situations - Follow-up action - Perform stress-testing to identify vulnerable sectors in the portfolios: • Real estates • Construction sectors • Others - Update of credit risk objectives - Review and forecast the real estate market development for a relevant	**Maximum** 4 points

- The credit agency's rating might have a much longer time lag to adjust in a down-turning market than in an up-turning market.		future period to consider if credit risk objectives need to be updated Update credit policy, guide, and standards - Increase review frequency - Lower review trigger - Tighten new loan criteria - Update classification of the loans in the relevant sectors Update of risk management strategy - Review the opportunity of portfolio rebalancing given the forecast of the economic situations and real estate market in a particular geography - Keep updated with the HKMA's latest circulars to review if any key regulations are to be complied with	

3.2.4 Alternative assessment format with simulation case-based interactive short and long questions and interactive dialogues for assessment

Note to trainers

The suggested alternative assessment format is a simulation case integrating assessment with short questions, a long question requiring written responses and a case-based interactive question including assessment with dialogues. Trainers considering adding dialogue assessment to written evaluation may refer to this alternative assessment format.

Suggested administering process:

1.Administering process with short questions

Step 1: Before Class

- The trainer instructs learners to read the assessment case and complete pre-class preparation with the provided templates
- All learners not having completed the preparation should attend the next class.

Step 2: Before the Assessment

- The trainer instructs the learners to save their documents with the answers and put the following information at the beginning of the word documents:
  - Name
  - Question-number
- The trainer reminds learners to organize responses in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and to evaluate real-life applications supported by examples.
- The trainer gives the learners 10 minutes to review and modify response to the first question individually
- The trainer then goes to the next step

Step 3: Learners Sharing Views

- Each learner teams up with one other learner to discuss the answers for 5 minutes
- Then, the trainer facilitates in-class group-sharing for 5 minutes
- After the group sharing, the trainer requests the learners to complete the second question repeating the previous step
- The trainer repeats Step 2 and 3 until the learners complete all three questions.

Step 4: After the Assessment

- The trainer requests learners to submit the answers to a designated email address
- The trainer scores the answers of the individual learners against the pre-set answers
- The learners get maximum marks for answers that are similar in meaning and context to the pre-set answers organized in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and evaluate real-life applications supported by examples.
- The trainer registers the scores of the assessment

Explanation of the sample short questions in the simulation case and learning points

Explanation

- The questions help learners state the negotiation tactic based on solid analysis done before attending a negotiation session.

Learning points

- The learners learn how to articulate analysis of success drivers of negotiation to arrive at a tactic to be conveyed to seniors and executed.

2.Administering process for the Long Question

Step 1: Before Class

- The trainer instructs learners to read the assessment case and complete pre-class preparation with the provided templates
- All learners not having completed the preparation should attend the next class.

Step 2: Before the Assessment

- The trainer instructs the learners to save their documents with the answers and put the following information at the beginning of the word documents:
    - Name
    - Question-number
- Learners are allowed to go to internet for more relevant information
- The trainer gives the learners 60 minutes to complete one long question individually
- After 60 minutes, the trainer goes to Step 2

Step 3: Group Sharing Views

- The trainer requests learners to submit the answers to a designated email address
- Then, the trainer facilitates class-sharing for 30 minutes

Step 4: After the Assessment

- The trainer scores the answers of the individual learners against the pre-set answers.
- The learners get marks for answers that are similar in meaning and context to the pre-set answers
- The trainer registers the scores of the assessment.

Explanation of the sample long question and learning points

Explanation

- There is one long question for each submodule
- The question helps learners apply the knowledge and skills obtained in class and the workplace, for example
    - Experience with borrowers, supervisors, and working peers
    - Knowledge acquired from team-, department- and bank-meetings
    - Knowledge extracted from interactions with the industry networks
- The learners should present the total solution
- A long question consists of five sub-sections for scoring, all related to analysis of key drivers in the case situation to arrive at the negotiation tactic.

Learning points

- The learners would become aware that how, in the real work environment, collecting data and information regarding the counterparty of the negotiation leads to identifying key success drivers and subsequent unbiased judgments for negotiation tactic development.

2.Administering process for interactive questions for dialogue assessment

Step 1: Before Class

- The trainer instructs learners to read the assessment case and complete pre-class preparation with the provided templates.
- All learners not having completed the preparation should attend the next class.
- The trainer may arrange additional assessors according to the number of learners.

Step 2: Before the Assessment

- The trainer reminds the learners to review the case facts and their responses to the short and long question while awaiting their dialogue assessment sessions.
- The trainer reminds the individual learners of the assessment time slot.
- The trainer confirms with each learner:
    - o the name,
    - o the successful submission of written responses to short and long questions

Step 3: During the Assessment

- Each dialogue assessment is done between one trainer/assessment and one learner.
- The trainer/assessor scores the answers of each learner against the pre-set checklist.
- Each assessment session lasts for 10 minutes.
- All assessment sessions are completed within 90 minutes.

Step 4: After the Assessment

- The trainer/assessor checks the scores on the checklist.
- The learners get marks for answers similar in meaning and context to the pre-set answers.
- The trainer registers the scores of the assessment.

Sample

A 47-page sample simulation case for alternative assessment format with simulated case-based interactive short and long questions with interactive dialogues is in Appendix 7.

Explanation of the sample interactive dialogues assessment and learning points

Explanation

- There are 10 minutes for each dialogue assessment session.
- The interactive dialogues help learners deliver the related knowledge, skills and behaviours derived from the negotiation tactic based on solid analysis of key drivers for negotiation success.
- The learners should choose adequate responses for each dialogue to maximize negotiation outcomes.
- A long question consists of six dialogues, based on negotiation process, for scoring.

Learning points

- Learners would become aware of how one may execute a planned negotiation tactic backed up by solid analysis of negotiation with effective dialogue in a negotiation session.

Overall explanation of sample simulation case covering short and long questions and interactive questions for dialogue assessment

Explanation

- Sample provided as alternative assessment format is for trainers who consider adding dialogue assessment to written assessment.

- Users may select several ILO to compile the case-based questions so that learners can integrate knowledge, skills and behaviours to finalize the written response to the short questions and long questions, as well as case-based dialogue assessment.

- The suggested response templates in the sample simulation case facilitates the responses by the learners. The learners refer to the limited information provided and respond to the questions with ingredients of similar cases from the live experience or the publicly available knowledge.

- Learners will go through the case-based interactive question upon completing all sub-modules in a Module.

- The Users may consider adapting publicly known cases with much information in the public domains. The Users may adapt the financial figures in the listed non-financial companies. These resources facilitate learners' understanding and discovery of the applicability and limitations of financial ratio analysis in a real-life situation.

Learning points

- To respond to the short questions, long questions and case-cased questions in the simulation case, a learner needs to perform a 360 degree inside-out identification of essential competency. The learners will become aware of the necessity to broaden the horizons on required competency related to knowledge, skills and behaviours including skills to conduct dialogues.

4 Assessment Criteria and Rubrics

Assessment Criteria

- When a learner's response matches closely with one of the answers on the response plan, points are earned.
- A learner earns maximum points when there are more responses than those on the response plan, and each matches closely.
- Instead of looking at the score of individual assessment tasks, the trainer will refer to the integrated scores of all assessment tasks to review if a learner demonstrate essential knowledge and apply the knowledge in handling simulated situations and work situations in the following manner, where applicable:
  -Ability to quote relevant facts in supporting the arguments
  -Contrast different approaches or theories
  -Evaluate real-life applications supported by examples

Applicable for Modules 1, 2 and 3

Suggested Assessment Rubrics (Short Questions)

Maximum points from Question (1)	7 points	
Maximum points from Question (2)	7 points	
Maximum points from Question (3)	7 points	
Maximum Marks	20 points	20%

Note: If a learner obtains full marks in each question, the maximum score is still 20 points

Suggested Assessment Rubrics (Long Questions)

Maximum points from Question (1)	8 points	
Maximum points from Question (2)	8 points	
Maximum points from Question (3)	8 points	
Maximum points from Question (4)	8 points	
Maximum points from Question (5)	8 points	
Maximum Points to Obtain (From Question (1) – (5))	40 points	40%

Suggested Assessment Rubrics (Case-Based Interactive Questions)

Maximum Points to Obtain	40 points	40%

5 Performance Grade

Calculation of scores

Module 1: Formula to Calculate Final Score

Short and Long Questions (a)	Case-based Questions (b)	Total score (a)+(b)
$\left(\frac{\sum \text{Scores of all written assessment}}{5}\right)$	Scores of the case-based questions	

Module 2: Formula to Calculate Final Score

Short and Long Questions (a)	Case-based Questions (b)	Total score (a)+(b)
$\left(\frac{\sum \text{Scores of all written assessment}}{3}\right)$	Scores of the case-based questions	

Module 3: Formula to Calculate Final Score

Short and Long Questions (a)	Case-based Questions (b)	Total score (a)+(b)
$\left(\frac{\sum \text{Scores of all written and dialogue assessment}}{2}\right)$	Scores of the case-based questions	

Performance Grades

The learner will achieve different outcome performance grade according to the total scores obtained in all the assessment activities. The passing criteria for individual Submodule and for overall Module are the same as stated below:

Performance Grade	Point Range	Definition
Distinction	91 – 100	The learner's work is distinctive. It exceeds the intended subject learning outcomes.
Good	76 – 90	The learner's work is good. It exceeds the intended subject learning outcomes.
Pass	50 – 75	The learner's work is satisfactory. It largely meets the subject learning outcomes.
Fail	21 - 49	The learner's work is below the required subject learning outcomes. The learner needs to retake all the assessments
Re-do	Below 20	The learner needs to retake the whole training programme

Please note that learners can meet the ECF-CRM benchmark by undertaking accredited training programme and passing examinations offered by the examination provider for the ECF-CRM qualifications.

G. SUPPORT MATERIALS FOR TRAINERS

The trainer is to provide the learning content. This section offers a quick reference to the content. Apart from providing the learning content, the trainer will also prepare a list of optional reading materials and a helpful website.

1 Module 1 Content Notes

1.1 Submodule 1: Early Warning Signal

<u>Note to trainers</u>
Trainers can pick, change, and repackage the content sample below according to learners' needs

1.1.1 Introduction

Credit Risk Management takes place at both the account level and the portfolio level. Since various external and internal factors affect the credit risk level changes, day-to-day monitoring of account transactions and portfolio changes is essential. Measuring, analyzing, and controlling aggregated risks enables a bank to monitor the credit quality of loans by industries, counterparties, and geographies (and others). Early detection of credit quality deteriorating signal makes it possible for a bank to take loss prevention measures promptly. In addition, adequate credit risk management helps optimize the capital to support credit risk arising from credit portfolio.

1.1.2 Monitoring Portfolio – theory and practice

1.1.2.1 Basics in CRM for identification of appropriate methods

Note to the trainer: RPs must be familiar with Credit Risk Management, constraints, and challenges, the systematic approach to tackle challenges, and the technology trend to overcome the obstacles.

An overall effective governance framework for credit process supports the RPs to carry out continual risk monitoring. RPs must be familiar with the circumstances leading to credit risk deterioration and the corporate finance models, which explain voluntary defaults to sensitize themselves with possible early warning signal.

(1) <u>Importance of credit risk management in CAMEL[9] rating</u>

RPs should be able to relate the credit risk management quality to the CAMEL rating. Credit Risk Management does not stand alone as an isolated function within a bank. Credit Risk Management Quality has implications on the CAMEL rating. The HKMA adopts the international "CAMEL" rating system to assess financial conditions and overall soundness of banks in Hong Kong. Inadequate credit risk management not just results in potential credit loss but could also create risks in other CAMEL risk areas (e.g., legal risk, reputation risk, and others). The table below shows the eight inherent bank risks:

Inherent Risk	Description
Credit risk	The risk that a borrower or counterparty may fail to fulfill an obligation. Credit risk assessment involves evaluating both the probability of default by the counterparty, obligor, or issuer and the exposure or financial impact on the AI in the event of default.
Market risk	The risk of an Authorized Institution's (AI) financial condition deteriorates due to the adverse movements in market rates or prices, such as foreign exchange rates, commodity, or equity prices. The primary determinant of the inherent market risk of a business line is the volatility of relevant markets. In assessing inherent market risk, one must consider the interaction between market volatilities and business strategies. For example, a trading strategy focusing exclusively on intermediation between end-users will tend to result in less market risk than a purely proprietary strategy.
Interest rate risk	The risk to an AI's financial condition resulting from adverse movements in interest rates. In determining the levels of interest rate risk, assessments are made of the levels of repricing risk, basis risk, options risk, and yield curve risk. In addition, evaluations are made of funding strategy with respect to interest rate movements and the impact of the overall business strategies on interest rate risk.
Liquidity risk	The risk that an AI may be unable to meet its obligations as they fall due. This may be caused by "funding liquidity risk", i.e., the AI's inability to liquidate assets or to obtain funding to meet its obligations. The problem could also be caused by "market liquidity risk," where an AI cannot easily unwind or offset specific exposures without lowering market prices significantly because of inadequate market depth or market disruptions.
Operational risk	The risk of direct or indirect loss resulting from inadequate or failed internal processes, staff and systems or from external events.

[9] Risk-based supervisory approach, Microsoft Word - SA-1_8Oct_.doc (hkma.gov.hk)

	The evaluation of operational risk involves an assessment of both product and bank-specific factors. The relevant product factors include the maturity of the product in the market, the need for significant fund movement, the impact of a breakdown in segregation of duties and the level of complexity and innovation in the marketplace. A bank's specific factors, which can significantly increase or decrease the basic level of operational risk, include the quality of the audit function and programme, the volume of transactions in relation to system development and capacity, the complexity of the processing environment and the level of manual intervention required to process transactions.
Reputation risk	The potential that negative publicity regarding an AI's business practices, whether true or not, will cause a decline in the customer base or lead to costly litigation or revenue reductions. Market rumors or public perceptions are significant factors in determining the level of risk in this category.
Legal risk	The risk arising from the potential that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial condition of an AI.
Strategic risk	The risk of current and prospective impacts on earnings, capital, reputation or standing arising from poor business decisions, improper implementation of decisions or lack of response to industry, economic or technological changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve these goals, the resources deployed to meet these goals and the quality of implementation.

(2) Credit risk

Credit risk is the risk of an economic loss from the failure of a counterparty to fulfil its contractual obligations. Its effect on the bank is that it needs to replace the initially planned cash flows with an updated replacement cost. Credit risk arises during the lifetime of an obligation, from disbursement, subsequent drawdowns/transactions, payment, and settlement, and involves the possibility of non-payment.

Note to the trainer: the trainer may supplement the information on credit risk arising from trade finance and acceptances, interbank transactions, commitments and guarantees, interest rate, foreign exchange, credit derivatives (examples are swap, options, forward rate agreements, and collateralized debt obligations) according to needs of learners. Self-study materials for learners in <u>*(G) (4) Support Materials for Trainer*</u>

(3) Credit risk management system

Credit risk management system carries out the credit risk management activities, requiring banks to allocate adequate resources for the delivery of critical processes which are justified and supported by appropriate documentation:

- People
- Process
- Documentation

The table below lists out the three orientations of credit risk management:

	Credit Risk Management Orientation	Examples
1	Process	A risk management system refers broadly to the policies, systems, and procedures adopted by banks in identifying, measuring, monitoring, controlling, or mitigating, and reporting the various types of risk they face[10]. Credit risk management system is broadly in alignment with this description.
2	Purpose	A credit risk management system enables a bank's capacity to identify risks and react to financial stress. Credit Risk Management is the comprehensive risk management system to manage credit risk, the risk that a borrower or counterparty fails to meet its obligations.
3	Actions	A credit risk management system betters a bank's understanding of the adequacy of its capital and loan loss reserves concerning the credit risk taken. It enables a bank to cumulate its credit risk-related knowledge and experience for quality implementation of good practices of credit risk mitigation measures and remedial actions.

(4) Credit risk management governance

RPs must understand the system view of Credit Risk Management thoroughly. It is a continuous governance process of credit initiation, risk monitoring, risk mitigation, and check and balance on credit guidelines to ensure the bank's credit risk stays within the pre-set risk appetite to minimize loss and optimize capital utilization. Credit risk management is both a science and art, taking the investigative approach to assess credit risk.

(5) Credit risk management scale

Credit Risk Management requires resources: trained and skilled people and finance. RPs should be able to judge if the in-house credit risk management system has a sophistication that is in line with the bank's strategic positioning. The HKMA expects all banks to have comprehensive credit risk management systems appropriate to their types, scope, sophistication, and scale of operations. These systems should enable banks to identify, quantify, monitor, and control credit risk and ensure that adequate capital resources are available to cover the risk.

[10] HKMA SPM IC-1 General Risk Management Controls

(6) Credit process

The RPs should possess knowledge about end-to-end credit process, which is fundamental to credit risk management. Therefore, the HKMA has specific clauses (e.g., CR-G-1) on the relevant process for RPs' reference.

- Credit strategy and policy
- Risk Management
- Credit Initiation
- Credit Evaluation, Approval and Review
- Credit Administration
- Credit Measurement and Monitoring
- Problem Loan Management
- Independent Audit

(7) Credit risk management structure

The HKMA has a suggested basic structure of credit risk management system, but banks have some discretion, for example:

- Product type
- Degree of sophistication (markets, borrowers, counterparties)
- Scale

(8) Constraints and challenges

Portfolio credit management is to overcome constraints and challenges regarding the limitations and challenges of managing the credit risk of individual accounts. The table below shows examples on constraints and challenges:

Constraints	Challenges
Information asymmetry[11] affects the quality of Financial Analysis	System risk impacts industries and industry risk impacts borrowers and counterparties

[11] Refer to Module 2 content notes as well

(9) Technology solutions to overcome constraints and challenges

Note to the trainer: with the fast development of Artificial Intelligence technology applications in credit risk management, the RPs should be encouraged to keep abreast of the latest development in the banking industry regarding the application of machine learning[12] *which will gradually supplement the traditional blind spots in credit risk behaviours.*

The table below shows where artificial intelligence technology brings improvement in credit risk management:

Application of Artificial Intelligence for Estimating Probability of Default	Application of Artificial Intelligence in Early Warning Signal
Traditional probability of default (PD) models relies heavily on logistic regression. Logistic regression models are relatively easy to understand and interpret. However, some recent Artificial Intelligence technology experiments show that it outperforms logistic regression models in multiple performance measures.[13]	Traditional methods rely much on expert judgment. Artificial Intelligence is good at generating credit default signal by discovering patterns based on large volume, high-velocity data. With sufficient computational power, Artificial Intelligence algorithms can generate early warning signal using indicators from various sources and increase the indicators' accuracy.

(10) Analytical approach on risk

Meticulous analysis of financial and cash flow statements helps to overcome the issues of information asymmetry. In addition, studying external, industrial, and internal factors helps to have a comprehensive approach to identify and include all risk factors with a high potential of happening and significant impact on the risk level of the loans. The table below shows examples of risk factors:

External, Industrial, Internal Factor Analysis	External Risk Factors	Industry Risk Factors	Internal Risk Factors
Explanation	External risk factors which have general impacts on all the borrowers	Industry risk factors have general impacts on all the companies within the industry	Internal risk factors which are specific to the borrower or counterparty
Examples	Social-political risk Macro-economic risk	Industry regulatory risk	Business risk Financial risk

[12] Trainers may provide articles on the latest AI applications for credit risk management
[13] Artificial Intelligence for Credit Risk Management | Deloitte China | Risk Advisory

(11) Credit default circumstances

RPs should be aware of different circumstances when a borrower or counterparty fails to meet its obligations, which has a consequence on its credit rating and hence the performance of the loan portfolio. This practice applies to the banking and trading books, on and off the balance sheet. The circumstances of default are summarized below.

- Non-fulfilment of debt servicing
- Non-fulfilment of other terms and conditions

The RPs should be sensitized to the above circumstances so that appropriate reminders to the client would help the bank to arrive at a win-win situation where the borrower's creditability remains intact, and the bank keeps on meeting risk-return targets.

(12) Theories/models for credit risk management

One of the models which explains the voluntary default behaviour of a borrower is the **Merton Model**, which attempts to explain why shareholders would default with option theory. An RP should thoroughly understand this model to sensitize the circumstances under which a borrower is likely to default.

(13) Corporate finance theories relevant to credit risk management method

Note to the trainer: RPs should be familiar with the corporate finance theories which explain the corporate borrowers' behaviours which could lead to increased default risk.

The table below describes the corporate finance theories which explain the behaviours of the corporates, which might lead to potential circumstances resulting in credit default. For instance, if the shareholders encourage the board of directors' bonus pegged to stock price rather than the company's financial strength, it's natural to expect the board to develop a corporate strategy to maximize stock price.

Year	Corporate Finance Theory	Focus of the Theories	Possible behaviours
1960s	Trade-off theory	These studies focus on the analysis of benefits and costs deriving from leverage. They study how the firm balances the bankruptcy costs with the help of tax shields derived from taking on debt.	A company sets a target debt ratio which it aims to achieve. i.e., static capital structure.
1970s	Agency Theory	These studies focus on the conflicting interest between managers and shareholders; and between creditors and shareholders.	A company's shareholders make decisions through agencies, while the shareholders are agents for creditors. But creditors do not have a say in the management.
1st half 1980s	Pecking Order Theory	These studies focus on the information asymmetries among investors and firms.	A company's less informed investors need an incentive, i.e., a higher return to invest in risky securities. Internally generated funds, therefore, represent the best financing option, whereas using external capital would be the last finance alternative.
2nd half 1980s	SWOT PEST	These studies focus on the corporate finance structure based on the factors associated with industrial strategies and corporate organization.	A company's management band strength, quality of management, and industrial strategies impact its decision on the debt-equity mix.
1990s	Various studies	The studies in this period focus on the trade-off theory and the pecking order theory	Refer to the studies in the 1960s.
2000s	Various studies	The studies in this period focus on the study of the capital structure being a consequence of the necessity of market timing.	Conduct adequate empirical analyses of the structure of corporate finance.

1.1.2.2 Basics in credit strategies for identifying crucial area of monitoring

(1) Elements of credit strategy

Note to the trainer: RPs should be familiar with the modern portfolio theory of building a portfolio of more borrowers. Modern banking risk management builds upon the view that a portfolio of loans is less risky than single loan[14].

Adequate credit risk strategy consists of credit rating assessment, credit monitoring, risk mitigation, and timely payment follow-up. For instance, portfolio diversification is a credit risk strategy based on the premise that given a particular loan amount, the more the borrowers, the lower the probability of default, up to a certain extent, and vary according to circumstances.

(2) Portfolio credit risk management objectives

Note to the trainer: RPs should be familiar with the five portfolio objectives to exercise good credit risk management judgment.

Proactive management enables a portfolio to generate profit, produces a reasonable return on equity, enabling a bank to survive adverse situations. Credit risk management wants to achieve five objectives with adequate credit risk management at account and portfolio levels. The analytical framework below shows the relations between the objectives and credit risk management.

Portfolio Level Credit Risk Management	**Establish Risk Appetite**	**Rebalance Portfolio Risk Level**	**Rebalance Portfolio Return**	**Monitor Loan Provisioning**	**Review and Act upon information feedback**
Credit risk management objectives	**Compliance with credit policies**	**Select the opportunities with the adequate risk**	**Price the risk adequately**	**Minimize bad debt**	**Feedback to the credit policies improvement**
Account level credit risk management	**Solicitation**	**Risk Assessment**	**Pricing**	**Monitoring**	**Reporting**

[14] ***Additional Resources – Suggested Cases for Newsroom to discuss importance of having more borrowers***

- ***Peregrine Investment Holdings*** - *Investment bank failure caused by default of a single loan (1/4 of the Bank's equity capital) to an Indonesia taxicab operator.*
- ***Carrian Group*** - *The Group is the single largest borrower of the subsidiary of a Malaysian bank (exceed the Bank's equity capital). Its credit default also caused the failure of the bank.*

1.1.2.3 Basics to identify signals for escalation

The RPs should possess knowledge about the end-to-end credit process because deterioration of credit quality generates noises, i.e., early warning signal that will show up throughout the process:

- Credit strategy and policy
- Risk management
- Credit initiation
- Credit evaluation, approval, and review
- Credit administration
- Credit measurement and monitoring
- Problem loan management
- Independent audit

Early warning signals for credit risk are indicators that specifically anticipate credit risk events. For example, the quantitative or qualitative indicators of asset quality, capital, liquidity, profitability, market, and macroeconomic metrics can be early signals. Together with other early warning indicators from the different risk areas (CAMEL), they provide information for timely remedial actions at account and portfolio levels.

(1) Credit risk management process: identify, measure, monitor and control

A complete credit risk management comprises the four stages of identification, measurement monitoring and controlling credit risk. Therefore, quality credit risk management requires cross-enterprise collaboration. Through collaboration, the bank can identify early warning signals' timeliness. The summary below shows the enterprise collaboration.

Credit risk management process	**Sources**	**Information level**	**Information source**		**Endeavor to reveal early warning signals**
			Internal	External	
Identify	Geo-political situation (Also refer to Note 1)	Portfolio		X	Analyzing the impact of geo-political situations on credit risk is particularly important for sizable banks with borrowers and counterparties in the regional or global markets
Identify	Macro-environment scanning (Also refer to Note 2)	Portfolio		X	Applying business tools such as PESTEL to assess outcomes of macro-environment scanning
Identify	Business environment scanning	Account		X	Applying business tools to summarize outcomes of competitive environment scanning: - SWOT Analysis - Five Force Model - Canvas Business model

Identify	Portfolio analysis	Portfolio	X	X	Analyzing the portfolio assuming stressful conditions using: - Stress testing - Sensitivity analysis
Measure (Also refer to Note 3)	Portfolio analysis	Portfolio	X		Analyzing the portfolio characteristics assuming normal conditions: - Product type - Product growth - Sector type - Sector growth - Internal credit rating - Trend and ratio - Risk migration - Risk concentration - Asset quality - Provision - Connected parties
Monitor	Borrowers' information	Account		X	Monitoring the borrower's situations - A key executive of a borrower is in ill health - A change in the borrower's leadership team - The borrower is the subject of litigation which have a significant impact on his financial position - The borrower has difficulty servicing other loans even though the loan in concern is still serviced timely
Monitor	Credit administration (Also refer to Note 4)	Account	X		Monitoring the fulfillment of terms and conditions of the loan account
Monitor	Migration of internal rating (Also refer to Note 5)	Portfolio	X		Monitoring the deterioration on repayment capability
Control	Collateral and guarantees review	Account	X		Reviewing the market value, legal right, and control - Market price increase/decreases

					- Condition of collaterals should be surveilled - Control over collateral is robust/questionable - Default event in another bank
Control	Alerts from reporting system	Portfolio	X		Establishing alert trigger when aggregated exposure approaches various pre-set portfolio limits as set out in the credit policy

Note (1) Consciousness of the geo-political situations – early warning signal
Globalization trend in the past decades has increased the interdependency between the prosperity of sovereign states. For instance, instability in one region could be a source and cause of instability in another.

Note (2) Generating early warning signal via environment scanning
RPs should be aware that continuous scanning of business and economic cycles is essential, and regularly stress-test the portfolio is a required discipline against adverse market scenarios.
For instance, a slowdown in business or a negative trend in the borrower's operations signals a potential weakness in the borrower's financial strength but has not reached a point to jeopardize the servicing of a loan. Poor performance in the industry in which the borrower operates.

Note (3) Generating credit risk indicators
RPs may refer to "Basics to detect changes of risk indicators" to grasp a quick understanding of the risk indicators.

Note (4) Generating early warning signal during credit administration fulfillment
Credit administration process provides an excellent pool of data and information that hints at credit behaviours (and their changes) on individual loan accounts. Organizing, aggregating, and reporting the data and information from credit administration completes the management information cycle from loan initiation down to loan maturity. It also provides an early warning signal as any non-fulfillment of terms and conditions of the loan is a hint of the deteriorating repayment capability of the borrowing accounts.

Note (5) Generating early warning signal via review on the migration of internal ratings
With the advancement of information, the internal rating has become increasingly important management and supervisory tool.

- Banks seek to improve the sophistication of their loan classification system beyond the grading system currently employed for regulatory reporting.
- Banks seek to adopt multiple grades for loans that are not yet irregular and to develop the ability to track the migration of individual loans through various internal credit ratings.

(2) Signals at account level

RPs should listen to the noises throughout the credit process because they could be early warning signals about the credit risk deterioration in accounts and portfolio levels. The table below lists out some credit risk management methods to detect noises continually.

Performed by	Proposed Frequency	Methods to identify early warning signals
Front office	On-going	Keeping regular contact with customers (including site visits and meetings)
Back office	Daily	Following up documentation deficiencies
Middle office	Daily	Reviewing exceptions and overdue accounts
Middle office/ Back office	On-going	Monitoring compliance with credit facility terms
Middle office/Compliance unit	Daily	Monitoring compliance with internal and regulatory limits
Back office	Weekly	Identifying and following up outstanding credit reviews and expired facilities
Back office Back office	Daily Quarterly	Performing collateral revaluation - Stock and shares - Real estate (classified accounts)
Middle office/Senior management	Monthly	Reviewing adequacy of provision for individual accounts
Middle office	On-going	Monitoring performance of large exposures
Front office/ Back office	Daily	Following up customers for late payments
Front office (less serious) / Middle office	On-going	Taking remedial action for loan recovery

(3) Signal at portfolio level

The analytical framework below shows how the early warning signal is identified at portfolio level with the monitoring of target-actual performance gaps:

Portfolio Performance		**Credit Risk**	
		Quality of Loans Meets Target	**Quality of Loans Below Target**
Business Risk	**Product % meets target**	**CRM** Monitor portfolio continuously **Business Strategy** Monitor portfolio continuously	**Credit Strategy** Take Immediate remedial actions to lower portfolio credit risk and to ensure adequate loan provisioning **Business Strategy** Adjust the business strategy to reduce risk level of the new loan intakes
	Product % below target	**Credit Strategy** Look for enhancement opportunity **Business Strategy** Reshuffle business targets within credit risk appetite for compensating profit	**Credit Strategy** Take Immediate remedial actions to lower portfolio credit risk, to ensure adequate loan provisioning and capital adequacy **Business Strategy** Adjust the business strategy to reduce risk level of the new loan intake

(4) Signals at macro-economic level

The financial crisis in the economies in recent decades resulted in severe vulnerabilities in the region or the global markets. There are five types of exposure, including macro-environment, market, credit, US Dollar liquidity, and contagion. In addition, several macroeconomic indicators might provide early warning. The indicators include, for instance, exchange rate, domestic credit, credit to the public sector, and inflation rate.

(5) Other essential signals

Note to trainers: Do encourage RPs to share other essential signals learned from their professional career, be them at the account, portfolio, and macro-level.

1.1.2.4 Basics of Sources and Causes of Changes for Remedial Actions

(1) Knowledge management of all inhouse, external and industry information

Note to trainers: RPs should be familiar with all sources and causes of changes in the risk level of different economies and industries to sensitize to the identification of early warning signal.

Many banks provide RPs with sufficient information/exposure to external environment changes with:

- Bank's proprietary economist report
- Bank's proprietary industry report
- Bank's proprietary expert sharing
- RPs share experiences among working peers
- Departmental sharing on lessons learned (e.g., default cases) from default event
- Sharing from the industry consultants engaged by the bank

It's RPs' responsibility to organize their knowledge[15] in an easily retrievable manner for more sharing among the peers within the team.

(2) Internal, external, and industrial factors

Note to the trainers: most RPs perceive the extreme challenge in identifying early warning signal. Instead, they should have an aerial picture of all potential risk factors.

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[15] ***Additional Resources***

International rating agencies have comprehensive research libraries on sovereign defaults. There is also research on the characteristics of failed banks based on loss given default. These lessons learned provide insight into the identification of early warning signals.

The table below lists out some possible combinations of various sources and causes leading to a single or multiple default events:

External Factors				**Industrial Factors**	**Internal Factors of Borrowers**
Public Health	**Geo-political**	**Government Policies**	**Economic**		
Pandemic e.g., 2020 pandemic	**Conflicts** e.g., Indian-China border dispute **Wars** e.g., Ukraine-Russia war	**Monetary policy** e.g., nations' overall money supply increased after the 2007 financial tsunami **Fiscal policy** e.g., the Construction of high-speed rail in China stimulated economic growth **Foreign currency control** e.g., China, Malaysia, India, and some other countries still exercise some foreign currency controls **Sovereign debt policy** e.g., local governments across China have borrowed substantially in recent years to fund public infrastructure improvements and other capital investments **Profit tax and tariff** e.g., worldwide and territorial approaches to taxation	**Economic Cycle** - Growth - Rapid Growth - Stabilization - Decline **Inflation rate** e.g., the Global inflation rate for the consumer price index is above 9% (March 2022) **Unemployment rate** e.g., the Unemployment rate for Chinese people ages 16 – 24 grew from over 10% in 2018 to 18.4% in May 2022. **Commodity price** - Oil - Bean **Stock market Index** **Property market index** **Banks' competition** e.g., fierce competition leads to loan pricing decrease	**Cyclical** (Counter-cyclical) **Regulations** e.g., China put forward antitrust guidelines and rules in e-commerce platforms, social media providers, and live-streaming services since 2020 **Technology advancement** e.g., technology advancement has driven out some long-time businesses with traditional business models **Environment rules and regulations** e.g., China had significant reform on its Environment Protection Law in 2015 **Energy prices** e.g., World Bank's energy price index increased by 26.3% from Jan – April 2022 and 50% from Jan 2020 – Dec 2021	**Life stage** - Start up - Growth - Rapid growth - Plateau - Decline **Business model** - Key business drivers - Business strategy to ride on key business drivers **Management quality** - Management team analysis - Via analysis with SWOT Canvas **Equity/debt leverage** **Sensitivity to the Five Forces** - Suppliers power (e.g., reflected in negotiation power) - Customers power (e.g., reflected in price sensitivity) - Product substitute - Competitions (e.g., reflected in market share) - government - operations

		Foreign direct investment policy e.g., FDI is still prohibited and restricted in a number of areas		**Supply chain switch** e.g., supply chain shift from China to some Southeast Asia countries since the Pandemic **Entrance hurdles** e.g., China forbids foreign investment in some sectors while encouraging it in others	

1.1.2.5 Exercising unbiased judgment

Credit Risk Management requires both scientific skills and the exercise of judgment. Knowledge management is the key to impartial and unbiased judgment.

(1) <u>Review and prioritize risk level of external, industrial, and internal factors</u>

RPs should understand that the systematic analysis of external, industrial, and internal factors is imperfect because of time change, information asymmetry, and technological advancement. All of these create uncertainties over time at account and portfolio levels. Such awareness enables the RPs to monitor changes continuously, identify and articulate the risk factor changes to the credit risk level changes. The table below shows examples of sources of risk:

Uncertainties	Sources of Risk at Account Level	Sources of Risk at Portfolio Level
Due to time changes	All external, industry and internal factors change with time (Note 1)	
Due to information asymmetry	Directors have fiduciary duty towards shareholders rather than creditor (Note 2)	
Due to technology changes	Technology advancement changes consumer behavior drastically over time (Note 3)	

<u>(Note 1) Account level uncertainties arising from change of time</u>
Credit risk changes continually. Continual monitoring with adequate tools is essential to ensure banks take timely remedial actions. The table below lists out some tools to gather data and information for assessing risk and its changes.

To Gather Data and Information for Risk Assessment			
Initiation	**Interim Review**	**Continual Monitoring**	**Unforeseen Event**
Borrower level - delinquency analysis **Portfolio level** - portfolio analysis	**Borrower level** - Site visit - Interview with borrower - Peer comparison **Portfolio level** - Portfolio monitoring	**Borrower level** - Five Force Model - SWOT analysis - Canvas business model **Portfolio level** - Environment Scanning on macro environment and industry environment	**Portfolio level** - Stress testing - Scenario analysis

(Note 2) Information asymmetry

Company directors owe the fiduciary duty to act in the best interest of shareholders. Therefore, creditors neither have complete information nor influence on the companies' business decisions.

Because of the above asymmetric characteristics of the director's duties towards shareholders and creditors, information asymmetry, among other uncertainties, might exist between directors and creditors. The analytical framework below shows some examples on information asymmetry:

	Known to Borrowers	**Unknown to Borrowers**
Known to Lenders	**Snapshot information** - Audited balance sheet - Audited income statement - Audited cash flow statement **Principles and regulations** - Company policies - Accounting principles - Law and regulations	**Credit portfolio behaviours** - Cumulated knowledge on portfolio behaviours over time
Unknown to Lenders	**Dynamic information** - Day-to-day business, income, and expenditure momentum **Assumptions** - Exhaustive and proprietary assumptions on pro-forma statements - Exhaustive and proprietary assumptions on cash budget	**Unpredictable credit risk events** - Black swans, an unpredictable event that is beyond what is normally expected of a situation and has potentially severe consequences

Note (3) Technology advancement and consumer behaviours

Technology changes could drive changes in consumer behaviours fast and dramatically, without pre-empting warning to non-leader entities. There are lessons learned from renowned companies. The table below shows some well-known examples.

Industry	**Technology Change with Significant Impact on Competitive Landscape**
Camera company	Digital camera replaced traditional camera
Shaving product company	Digital sales platforms, and shaving behavioural change, replaced traditional retail distribution channels
Smart phone company	Touch screen technologies replaced keyboard

(2) Review and prioritize contagious effects on portfolio performance

Upon aggregating uncertainties at the account level to the portfolio level, RPs should consider the correlation between industries, sectors, counterparties, and others, which results in either reduction or contagious effect on portfolio risk levels.

The table below shows examples of credit portfolio scenarios that may trigger contagious effects on portfolios. Therefore, identifying early warning signals of all these scenarios is essential. In addition, analyzing the causes and sources of root causes of these signals enables mitigation measures to minimize contagious risk to be taken timely.

		Credit Risk Indicator	
Sources and Causes		**Target Met**	**Target Missed**
Product percentage distribution	**Meets target**	Stable business environment	Unforeseen changes in - Systematic factors e.g., deteriorating economic conditions due to COVID19 pandemic outbreak - Industry factors e.g., European green policy requests all cargo fleets to achieve carbon emission targets
	Miss target	- Tendency to acquire loans from familiar sectors - Marketing strategy yet to be aligned with business strategy	- Marginal credit applications approved

(3) Assign independent party for risk monitoring

With identified early warning signals such as borrowers' difficulties in business situations, delinquency, or other irregular symptoms in any accounts, banks should assign competent credit RPs to conduct a detailed review of the creditworthiness and the repayment ability of the customers concerned.

- Management should appoint an independent officer to conduct the in-depth review
- The independent officer should recommend remedial actions to protect the bank's interest.
- The independent officer should subsequently report to the Credit Committee or senior management on the results of the remedial actions.

1.1.3 Identify early warning signal

1.1.3.1 Overview of credit administration function

(1) Compliance with T&C

Note to trainers: RPs should be familiar with credit administration regarding loan account credit quality. The monitoring is basic but essential to upkeep the quality of the loan account, hence the portfolio.

Banks should have designated departments administering their various credit risk-bearing portfolios. Credit Administration Department also performs the critical control and risk management functions. The table below shows the risk monitoring functions:

Control and Risk Management Functions[16]	**Credit Risk Monitoring**
- Ensure that new credit applications have been property approved	- Sustaining credit risk culture by compliance with credit guidelines
- Enter facility limits promptly and accurately into the computer system	- Reflecting credit risk in the portfolio risk level indictors
- Prepare loan documentation (loan agreements, guarantees, transfers of title to collateral to the bank)	- Ensuring secondary source of repayment when the credit goes default
- Arrange for the safe custody of important legal documentation	- Ensuring legitimate entitlement upon credit default
- Verify customer's authority to borrow	- Ensuring legitimate entitlement upon credit default
- Conduct valuation of collateral	- Monitoring periodically of the protection provided by the secondary source of repayment when the credit goes default
- Establish effective liens on deposits	- Ensuring source of repayment upon credit default
- Check whether drawdowns have been approved	- Ensuring that the drawdown purpose is the same as the loan application purpose.
- Arrange funding and coordinating with the Treasury function to fix interest rates for loan disbursement	- Ensuring risk taken is commensurate with the spread between funding cost and revenue
- Keep track of customers' compliance with credit terms	- Detecting early warning signals with the follow-up on irregularity regarding compliance with the credit terms
- Monitor the receipt of repayments	- Ensuring timely follow-up of any irregular repayments and detect if there are irregular events which could be default events
- Obtain customers' current financial information	- Detecting early warning signals with the follow-up on irregularities regarding compliance with the credit terms
- Keep credit files complete and up to date	- Ensuring timely identification of any missing information as potential hints of early warning signals.
- Producing management information on the credit portfolio	- Providing feedback to the management regarding compliance of credit guideline, changes in credit risk levels, irregularities, and credit portfolio performance.

[16] Section G Subsection 3.1 of HKMA SPM CR-G-3 Credit Administration, Measurement and Monitoring

(2) Operational review

Operational risk will flow over to credit risk in many circumstances. For instance, the oversight of the timely receipt of the complete set of interim financial statements might be a human error in the operational risk. However, the risk could flow over to the credit risk if the delayed submission is an early warning signal that the borrower has an issue with the auditor on the company's audited reports. Therefore, the RPs should be aware of, in compliance with and review all the operational risk management processes to control any possible operational risk.

1.1.3.2 Basics to Detect Changes of Risk Indicators

Credit risk analysis is a rigorous study of credit risk through meticulous dissections to overcome information asymmetry. Tracking credit risk indicators helps to fulfil the credit risk study objectives.

(1) Key drivers of credit risk (EAD, PD, LGD, Tenor): single debt and portfolio

The table below shows examples of risk focuses during different stages of a loan, including their quantification such as exposure at default, probability of default, loss given default and tenor risk, as well as control measures:

<table>
<tr><th>Stages of Loan</th><th>Credit Indicators</th><th>Quantification</th><th>Means of Risk Control</th></tr>
<tr><td>1.
Disbursement stage
What's the loss if the borrower goes default?</td><td>Exposure at Default (EAD), or credit exposure</td><td rowspan="2">Three concepts of exposure
Gross Exposure i.e., total commitment

Net Exposure i.e., used amount

Adjusted Exposure i.e., Net Exposure X expected usage given default</td><td rowspan="2">Credit limit
Per underwriting criteria</td></tr>
<tr><td>2.
Repayment stage
What is the loss if borrower goes default the remaining balance?</td><td>EAD, or
credit exposure
(Decrease gradually as the outstanding loan decreases)</td></tr>
<tr><td>3.
Disbursement and repayment stage
How likely the borrower will default?</td><td>Probability of Default (PD)</td><td>Statistical indicators
Represent the likelihood that a borrower will default during the lifetime of the credit.

The following indicators are means to measure the same risk expressed from different perspectives: e.g., default rate</td><td>Credit rating
Accept an application if it has best rating of "1"</td></tr>
</table>

		e.g., default Probability e.g., probability of default	
4. **Default stage** What will be the recovery amount?	**LGD** **i.e.,** 100% less Recovery rate	**LGD decreases over time** Credit Exposure less the amount of money recovered upon default, expressed as a percent of the gross exposure.	**T&C** Have borrowers to sign security packages upon underwriting to have stronger protection e.g., T&C to ensure speedy recovery upon default e.g., the bank is a creditor of higher seniority e.g., availability of lien on assets
5. Tenor What is the period in which some or all the loan amount is at risk?	**Tenor**	**Two concepts of tenor** - Notional tenor - Effective tenor	**Regular repayments** Shorten the tenor effectively

Note (1) Probability of default

The probability of default is a statistical indicator representing the likelihood that a counterparty will default in the future. The credit agencies develop models to compute the likelihood of default assignment to an individual account for underwriting consideration and ongoing credit risk monitoring. As a result of the 2007 financial crisis, the credit agencies' rating is subject to controversy[17]. In the wake of the financial crisis in 2007, the rating agencies came under criticism from investigators and economists.

Note to trainers: Encourage the learners to share examples of portfolio risk monitoring to draw out the basic understanding and to share the concepts more in depth. Example of relevant reading from Basel shows in the footnote.

Credit risk of single debt could be reduced when it is put into a portfolio. When traces of single debt in a portfolio becomes blue, one monitors the portfolio behaviours[18] to identify changes in credit risk. The list below suggests the indicators for portfolio risk management:

- Default correlation which is the key driver to the default of several debts by different debtors
- Value at risk which is higher for a higher probability of default
- Probability of default which are affected by default correlation

[17] Reference case: **Merrill Lynch** – sold more than $30 billion of collateralized debt obligations for a minimal amount in 2008.

[18] Measuring portfolio credit risk correctly: why parameter uncertainty matters, April 2009 (bis.org)

(2) Challenges to estimate credit risk

RPs must be familiar with the various hurdles to assess the credit risk level of an account. Considering the credit risk level, an RPs will be more capable of soliciting means to contain the credit risk within the bank's risk appetite.

Interactive and multi-dimensional risk factors

Identifying the relevant risk factor is challenging. When analyzing the risk factors, there are also multiple dimensions to consider. The table below illustrates an analytical framework that considers external and internal factors impacting a budget airline business probability of default, taking the wrong side to cover the energy price risk.

Risk Factors	**Impact on**				**Probability of Happening**			**Direction of Impact**	**Impact upon Happening**		
External factors	Business strength	Financial strength	Management strength	Cash flow	High	Medium	Low		Significant	Moderate	Weak
Energy price		X		X	X			Negative	X		

Information asymmetry about management team quality and integrity

RPs find it hard to ascertain management team quality if there is a lack of good relationship with borrowers. Public images of borrowers alone do not necessarily reflect management quality. The table below shows some examples where management integrity has disappointed the public:

Case	Company Nature	The Situation
1	Lab Test on Blood	The start-up company's claim on technology exists in theory but has not yet been proved.
2	Real Estate Development	Notorious credit default cases in the 80s showed over-expansion with substantial loans to single borrowers led to bank failures.

Assessing the borrower's resilience in face of adverse situation

The PD is the most valuable predictor in a loan initiation as it affects the bank's profitability and indirectly impacts the bank's other risk areas. Therefore, assigning an internal rating to each loan account is an effective credit risk management technique.

(3) Suitable method to aggregate risk at portfolio level

RPs should be familiar with each credit risk aggregation method's pros and cons to understand their evolvement and select the suitable method to track credit risk, apart from considering the portfolio scale and the bank's resources to manage credit risk. The table below shows some examples of the risk management method fitting different life stage of a loan:

Evolution Of Credit Risk Measurement	**Stage (1) Notional Amount**	**Stage (2) Risk Weighed Amount**	**Stage (3) Amount of Risk Weighed with Credit Rating**	**Stage (4) Internal Portfolio Credit Model**
Aggregation of exposures	Add up the Credit Exposure of each account	Add up the adjusted credit exposure of each account i.e., Credit Exposure X Estimated adjustment for the Risk	Add up the adjusted credit exposure of each account i.e., Credit Exposure X PD implied by the risk rating	The most sophisticated method with integration of all dimensions of credit risk to arrive at the portfolio level risk[19]
Pros	Simple	Simple	Refined representation of credit risk	Refined representation of credit risk
Cons	Ignore Probability of default	Ignore probability of default	Portfolio diversification effect not taken into account	Elevated cost of data aggregation for credit risk management e.g., model development, auding
Potential negative consequence	Overstate profitability of shareholders	Overstate profitability of shareholders	Understate profitability of shareholders	To be explored

(4) Convention of risk rating

From score 1 to 10, for instance, the smaller the number, the higher the quality. For example, a borrower with a credit rating of 10 has a higher default risk than another borrower with a credit rating of 1. Each rating has an associated default probability per different banks.

[19] The HKMA Requirements: The more sophisticated IRB[19] (Internal Risk-Based Approach) are due to meet specific requirements laid down by the HKMA.

(5) External credit rating agency service and precautionary measures

Credit rating agencies rate many debt securities. In such cases, the ratings assigned by the agencies will be valuable guides for institutions to classify debt securities. Therefore, external credit assessment institutions must adopt a methodology with objectivity assessed against rigors and systematic assessment methodologies to ensure the issue of credible and reliable credit assessments. Besides, the assessment methodologies must include all factors relevant to determining an entity's creditworthiness, documented, and with the back-testing method established in the concerned market segments before being recognized by the HKMA. Banks should take precaution that such credit rating, however, should not replace the institution's judgment on the credit soundness of the issuers.

(6) Limitation on use of credit rating agency's service and alternatives

There are limitations to the use of credit rating agencies' services. The credit ratings are basically per public information and additional information provided by the issuer, and financial, external, and industry information gathered by the agencies, which are all dynamic to affect future performance. Besides, credit rating agencies may withdraw the rating due to the absence of complete, available, and reliable information. Alternatives to credit rating agency's services include but are not limited to the followings:

- A bank could deploy only its internal rating system or only purchase available rating reports from the agency
- A bank could deploy the credit rating software developed by the rating agency
- A bank could develop its internal rating system and buy the agency report for reference/validation

(7) Internal credit rating system – large borrowers

Many variants of internal risk rating systems apply to large borrowers. Therefore, a bank should adopt the variants that could map the current loan classification grading system for regulatory reporting.

(8) Internal credit rating system – small business borrowers

There are challenges in two dimensions, namely, the availability of data and the relevant evaluation completeness.

(9) Benefits of multiple grades

Adding multiple grades for credits not yet irregular enables a bank to track the migration of individual credits through the various stages. This monitoring method will facilitate the early identification of deteriorating credits so that banks can take remedial actions to minimize credit losses.

Rating Attributes	Considerations In Developing Best Practices in Developing Risk Rating System
Dual rating	The rating system provides the measures including the probability of default (PD) and loss given default (LGD).
Rating granularity	For instance, rating 4+, 4, 4- instead of 4 only makes it easier to manage the portfolio because more minor risk level changes could trigger an early warning signal.
Consistency	Consistency application without deviation is the best practice. A 4 is a 4, no matter who the customer is.
Data-driven	The indicators/components must rely on precisely defined data such as the Debt Service Coverage Ratio.
	Qualities such as "management experience" can be quantified, e.g., "Strong" means the management team has served in the industry for a certain number of years. "Weak" means less than certain defined number of years in business.
Transparency	Final risk rating documentation includes all information so that different analysts can see how the rating was derived.
Technology	A bank could consider deploying a ready-to-use software solution with an intuitive user interface.
Rank order	Rank order the risk from least to most. To tackle increasing rank order granularity, a bank can differentiate "strong 4's" from "weak 4's".
Reporting	The system features built-in for storing data and providing ad hoc reporting capability to analyse the portfolio from numerous perspectives, such as rating concentration and migration over time.
Easy to use	Best practices that promote ease of use for users include input only once, having data linked with core systems, providing drop-down choices, and offering an option for user self-developed analysis.

To assign a credit rating to the borrower account when there is multiple rating, a bank needs to have a mechanism to determine the credit ratings to be given. The table below indicates examples of some possible solutions:

Establish Mapping	Establish Rules about Sources	Establish Rules about Inconsistency
Map the equivalence of internal credit rating to credit ratings provided by different rating agencies	Establish priority of deployment hierarchy regarding internal credit rating and external credit rating Establish priority of deployment hierarchy among different external credit rating	Adopt the prudence principle and use the most conservative rating

<u>(10) Direct influence of internal credit rating on banks' actions</u>

The more an RP understands the role of internal rating assignment in the credit risk management process, the more he will be sensitized to the probability of defaulting on a loan account. He becomes more sensitized to identify early warning signals, where appropriate, to protect the bank's interest.

A bank should apply an internal rating system in such a way as to exert a direct and observable influence on a bank's decision-making and actions. The table below shows some suggested applicable categories. Different banks may have more extensive applications.

Decision Categories	**Application of Internal Rating System in Direct and Observable Influence in the Area of**
Pricing	Variant pricing on product per borrower's rating
Limit	Setting limits for individual accounts
	Setting limits for portfolio exposures
Capital	Modelling and managing economic capital
	Assessing total capital requirements in relation to credit risks under the bank's Capital Adequacy Assessment Process
Risk appetite	Assessing risk appetite
Business strategy	Formulating business strategies to acquire new exposure and collection on problem loans
Evaluation against targets	Ascertaining profitability targets
	Ascertaining other performance targets
Remuneration	Framing performance-related remuneration for staff responsible for rating assignment/rating approval

(11) Benefits of assigning credit rating to borrowing accounts

Each bank will derive its benefits from the credit rating with the cumulation of more knowledge, experience, and validation through modeling. The list below shows some potential benefits of the internal rating assignment.

Quantification	The internal rating assignment is a risk quantification process. Unlike abstractly assessing the risk on probability and impact, the internal rating is statistically quantifiable and visible for management decision-making.
Efficiency	The internal rating is applied impartially with unbiased judgment throughout the loan portfolio assessment process, which elevates credit risk management efficiency.
Reliability	The internal rating that meets the regulators' input criteria will gain reliability to both internal management and regulators.
Insight Generation	Portfolio risk becomes visible, enabling management to ask great strategic questions and look for insights from the risk rating analysis.

(12) Relationship between regulatory requirement and internal credit rating

A bank might prefer to deploy an internal credit rating rather than an external one but keep that as a reference, though both are subject to regulatory requirements. *Trainers may refer to Recognition_of_External_Credit_Assessment_Institutions_Revised.pdf (hkma.gov.hk) regarding the external credit rating and CA-G-4 (hkma.gov.hk) regarding internal credit rating. Refer to 1.1.5.1 for the IRB approach.*

The table below compares the features of internal and external credit rating:

	Internal Credit Rating Team	Rating Agency
Data Challenge	Challenging to obtain updated data in quantity	Easier access to company data with their more influential on companies to provide updated data in quantity
Investment in financial resources	For large banks, the relative cost is insignificant. For smaller bank, the relative cost is significant.	Cost of preparation is paid by the companies which want to get rating for debt issuance.
Investment in HR resources	Recruiting specialized professionals and assign ratings to their counterparties.	Developing in talents to specialize in industries with heavy investment
Expertise	Evolving around the portfolio characteristics of the bank	Making service available for all entities of - Sovereign countries - Supranational - Municipalities' - Public finance borrowers - Large companies
Focus	Focusing on bank credit products	Focusing on companies which issue public debt
Information source	Sourcing from the public domains and any private information that the banks own	Dedicating analysts' resources to specialize in - Industry - Geography Global Offices situated near the entities being rated Direct access to the executives of the rated entities
Independence	Assessment made by teams independent from the marketing officers and the credit approvers of concerned cases	Independent opinion of the credit quality
Methods/Models and rating mechanism	Proprietary methodology/model and rating mechanism being a black box to the public without transparency	Publishing their methodologies and ratings for all rated entities on the web site
Application of the rating	Applying in multiple areas in the bank's risk management (Also refer to the regulatory review of this submodule)	Applying in the areas - Lending money - Loan pricing - Selling products
Brand Names	Inhouse service without separate brand name and for the bank's use only	Brands well known to the public such as - Moody's - S&P - Fitch Rating

RPs should note that despite the quality of credit rating on individual accounts, when the credit risks of loan accounts are aggregated to the portfolio level, the risk behaviours are different from the simple aggregation of risk.

(13) Evaluation on impact of the changes in the risk factors

Borrowers' accounts might have interactions, i.e., "covariance" and "correlation." With a more sophisticated aggregation method, aggregation of changes in credit risks at the borrower's account level might partially offset the risk level of each other. However, the covariances and correlations of accounts and portfolios might not be evident with less sophisticated modelling. The table below shows how asking strategic questions will be of value in evaluating the impact of the changes in risk factors.

	Portfolio Concentration	**Portfolio Correlation**	**Portfolio Vulnerability**	**Portfolio Objective**
Ask strategic questions and obtain the answer through understanding the portfolio behaviours.	Is there bias/concentration risk in the loan portfolio? Is the concentration favorable or unfavorable?	Are there correlated sectors within the loan portfolio? Does the risk of some sectors have contagion effect on others?	Are there sectors in the portfolio which are more vulnerable than others?	Are the credit risk diversification effort results effectively in portfolio risk profile change?

	Risk Assumption	**Risk Avoidance**	**Risk Diversification**	**Risk Mitigation**
Ask strategic questions and obtain the answer through understanding the portfolio behaviours.	Are there room for the bank to take up more risk? Is the bank willing to take up more risk? Does the bank have adequate risk capital for more credit risk?	Should we elevate the underwriting hurdle?	Should the bank diversify? Should the bank remain concentrated in the portfolio?	Should the bank add more mitigants to the new applications?

1.1.4 Identify the relationship of the risk level change with loan provision

The trainer's and guest specialists' sharing in seminar during the class:
Trainers will update the latest development on loan classifications, providing rules and regulations, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.

1.1.4.1 Regular forecast and review requirements

(1) The HKMA guideline

RPs should be familiar with the HKMA guidelines on the loan classification and related loss provision (refer to Submodule 5) to form a system view of the loan performance influenced by the changes in the loan provision, e.g., an increase in loan provision increases the carrying cost of and decreases the profitability of a loan.

(2) Multiple risk rating

RPs should be familiar with judgmental rating and risk rating migration; both serve as signals of credit risk change. Banks are encouraged to adopt a system that can map with but is more sophisticated than the 5-grade loan classification system currently employed for regulatory reporting. There are practical purposes to enable banks to perform credit risk management with more insights on:

- Credits that are not yet irregular
- The migration of individual credits through the various grades

The table below shows the difference between automatic-rating and judgemental rating

Automatic Rating System	Judgment Rating System
Based on - a pre-determined set of objective rating criteria e.g., past account performance	Based on - underlying creditworthiness of the borrower - financial strength of the guarantor(s) - financial strength of the collateral pledged - risk of specific transactions

(3) Loan provisioning and expected credit loss

Where losses are certain and likely, a bank makes specific provisions. Then, on top of these specific provisions' requirements, a bank makes general provisions in advance with the accounts yet to be identified. The table below shows conditions of provisioning:

Specific Provisioning	General Provisioning
Condition Where losses are certain and likely **Provision** The percentage to be provided will depend on the circumstances	**Condition** Over and above specific provision **Provision** Based on the historical loss experience Based also on the assessment of future economic trends in the market in which they operate

Since the 2007 Global Financial Crisis, it's recognized the cost of delayed provision of credit loss by the banks. Hence, accounting standards changed and required banks to provision against loans based on expected credit losses.

(4) Continual assessment of loan provisioning

The analytical framework below does not mean to be an exhaustive list but indicates the types of considerations for continual assessment of the forecasting of loan provisioning.

Consideration for Loan Provisioning	Consideration for Relevant Time Horizons
- Historic performance of each internal rating class of credit assets - Macro-economic outlook - Covariance and correlation of different sectors within the portfolio	- Historical performance of each internal rating class of credit assets - Present and future outlook

1.1.5 Identify Key Regulations, Report Remedy and Make Recommendations

1.1.5.1 Risk Profile Analysis and Reporting

The trainer's and guest specialists' sharing in seminar during the class: **Trainers will update the latest development on key regulations updates, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.**

Adopting the IRB approach will be an irreversible trend with IT technology advances and the availability of trained AI talents. Therefore, RPs should keep abreast of the direction and acquire a taste for the more sophisticated language applied in risk rating modelling. More information is available in CA-G-4 (Valuing Risk Rating Systems under the IRB Approach).

(1) Standardised and IRB approach and justifications[20]

The standardised approach improves granularity and risk sensitivity calibration of credit exposures and reduces excessive reliance on external credit rating, with a more granular approach for unrated exposures. The internal ratings-based approach constrains the use of internal models where appropriate (e.g., due to insufficient data to model portfolios with low-default history); and imposes minimum floor values for bank estimates; and specifies more refined requirements on estimation practice of banks.

Justification using different estimates

Banks may not necessarily use the exact estimates for regulatory capital calculation and internal purposes. However, the analytical framework below helps to justify using different estimates for regulatory capital calculation and internal purposes.

Risk Factors Consistency	Estimates Consistency	Rationale for the Differences
A bank can demonstrate consistency amongst the risk factors and rating criteria used in generating the estimates for regulatory capital calculation and those for internal purposes.	A bank can demonstrate consistency amongst the estimates used in regulatory capital calculation and those for internal purposes.	A bank has a comprehensive qualitative and quantitative analysis of the logic and rationale for the differences.

Justification using different models

Banks may keep more than one rating model for the same portfolio: one for calculating regulatory capital and the other for the benefit of benchmarking. The models may be developed in-house, from external resources, or in a combination. The analytical framework below shows the justification for maintaining different models for different purposes.

Justification of Model Applications	Use Test
A bank should provide documented justification for its application of a specific model to a specific purpose. In the documentation, the bank should justify the role it has assigned to that model in its credit management process.	The HKMA will assess whether the "use test" for IRB systems has been met, it will consider the extent to which a bank makes internal use of the system as a whole, rather than applying the test on an individual model basis.

The HKMA lays down the principle that: every bank should hold sufficient capital to cover credit risk and seek to strike an appropriate balance between risk and reward. However, banks achieve the

[20] Implementation of the Basel III Final Reform Package (hkma.gov.hk)

capital requirements **not** by avoiding credit risk exposure but by managing the risk a bank chooses to take to minimize potential credit losses. Early warning signals identified during portfolio management help a bank to take prompt review actions on capital adequacy.

(2) Regulatory capital versus economic capital

Once a bank can quantify credit risk with adequate methods, its next question is, "How much risk could the bank bear to take up?" The answer is dependent upon the amount of the bank's capital and the bank's capability to grow capital. Therefore, RPs should be aware of two categories of capital to sensitive themselves to the desirable loan applications. The analytical framework below attempts to summarize and compare these two capital categories.

Characteristics	Regulatory Capital	Economic Capital
Nature	Mandatory	Strategic
Prescription	Minimum levels of capital prescribed by regulators (BASEL accord: 8% of Risk Weighted Credit Portfolio)	Judgmental decision
Nature of decision	Formula Driven: defined in terms of balance sheet figures by risk class assets	Judgmental: decisions with justification
Target absorption	Absorb losses	Absorb unexpected losses

(3) Credit loss absorption

One method that enables the easy perception of economic risk is the compilation of credit loss distribution.

Based on Credit Loss Distribution	Regulatory Capital	Economic Capital	Deposits
Expected loss and below	Cost of doing business		
From above expected loss to below the insolvency		Cost of taking risk for more return	
Above insolvency			Loss offsetting by Deposits

According to the HKMA, "Loss-absorbing capacity is an essential prerequisite to an effective application of the "bail-in" stabilization option." *Trainers may refer to the HKMA's elaboration on the credit loss absorption on* Hong Kong Monetary Authority - Loss-absorbing Capacity (hkma.gov.hk)

(4) Senior management's role in credit risk monitoring

The senior management is ultimately responsible for the overview of credit process which includes credit strategy and policy, risk management, credit initiation, credit evaluation, approval and review, credit administration, credit measurement and monitoring, problem loan management and independent audits. The credit monitoring functions are performed at different levels.

The Board or the Credit Committee oversees credit monitoring on a portfolio basis and may take part in reviewing large or connected exposures. The back office provides support to the process through the measurement and reporting of credit risk exposures for management information. The middle office monitors limits and other risk parameters set down by the Board, reviews exception reports and checks that problem accounts are properly graded and provided against. It also performs periodic reviews and analyses the quality of the credit portfolio under stress-tests or other techniques. The front office monitors individual accounts on a day-to-day basis and recommends changes in internal credit rating and provisions where necessary.

(5) Tools for senior management's credit risk oversight

RPs should be familiar with the implication of the credit risk indicators of the portfolio to the senior management and try to obtain insight from the indicators by asking strategic questions.

Risk Indicators	Default Risk	Exposure Amount	Recovery Rate
Aggregate exposure versus portfolio limit by industry, country, product, type of counterparty - banks - non-bank financial institutions - corporates - retail customers, etc.		✓	
Total portfolio by internal credit rating and trend		✓	
Total exposure to groups of related countries		✓	
Large exposures		✓	
Connected lending		✓	
Asset-based lending with loan-to-value rations exceeding pre-set limits (e.g., mortgages with loan-to-value ratios exceeding 70%)			✓
Overdue accounts with ageing analysis (i.e., amounts overdue one, three, six months etc.)	✓		
Credit downgrades and loans rescheduled during the period	✓		
Interest suspended	✓		
Adequacy of provisions	✓		
Facilities expiring soon	✓		
Undrawn commitment ratio (i.e., undrawn facility amounts as a percentage of total facilities	✓		
Loan-to-deposit ratio	✓		
Results of stress-tests - Policy or limit amendments - Hedging - Exposure reduction (e.g., through asset sales, securitization, etc.) - Contingency planning for actions to be taken should a particular scenario happen	✓		

1.2 Submodule 2: Risk Mitigation

Note to trainers
Trainers can pick, change, and repackage the content sample below according to learners' needs

1.2.1 Introduction

Risk mitigation is a crucial credit risk management technique to reduce specific borrowers' account and portfolio level risks. Continuous risk mitigation is essential for banking system stability. Many past bank failures have occurred due to risk concentrations of some kind. Therefore, banks must properly manage risk concentrations from exposures to counterparties, industries, economic sectors, countries, or regions.

While some concentration risks are common to the local banking industry and cannot be avoided, banks can manage them by adopting proper risk control and diversification strategies. Safeguarding against risk concentrations should form a vital competence of the bank's risk management system. RPs should be familiar with the implication of credit risk indicators of the portfolio to senior management and try to obtain insight from the indicators by asking strategic questions.

1.2.2 Monitoring portfolio – theory and practice

1.2.2.1 Optimal risk level

Note to the trainers: *RPs should be familiar with risk tolerance, how much risk a bank could take (risk tolerance), risk appetite (willingness), risk limit (ceiling of risk appetite), and risk profile (actual risk taken).*

(1) Risk appetite

An AI's risk appetite (or risk tolerance) describes the level of risk a bank is willing to take regarding its financial capacity, strategic direction, and regulatory constraints. Examples are capital and liquidity requirements.

The Board is responsible for setting the overall risk appetite of the bank and approving its risk appetite statements. There is no standard way of expressing risk appetite. However, a bank's risk appetite statements should be comprehensive, including appropriate risk targets that are consistent with one other, and reflect a suitably wide range of measures and actionable elements that clearly articulate a bank's intended responses to a range of possible events, e.g., a loss of capital or a breach in risk limits.

(2) Importance of defining risk appetite

Comprehensive documentation on risk appetite is essential for internal and external audits for regulatory compliance. In addition, understanding the above enables RPs to exercise sound judgment on whether a credit transaction fits the banks' risk strategies.

Banks' risk appetite involves the careful maneuver of

- customer selection
- project selection
- underwriting criteria

Banks determine their risk appetite according to their financial and non-financial resources they have at their disposal. The table below shows considerations of risk tolerance level:

Financial Resources	Non-Financial Resources
- A bank's paid-in capital and retained earnings, together forms the bank's equity - Other capital which could be called upon to increase the capital, after fulfilling required conditions	- Robust Governance with the Competences of • The staff • IT systems • Internal procedures, and • Control systems

(3) Process of setting risk appetite

Note to trainers: *Sample conception of risk appetite statement of international, regional, or local banks with details could be located on the internet. There are overseas banks that publish documentation with sufficient details to understand their risk appetite conception process. Trainers may prepare for the interactive lecture with these materials.*

There are several perspectives to determine risk-taking. For example, the following shows three views to understand banks' risk appetites.

<u>View (1)</u>
Risk-taking is an integral part of the banking business which is carefully balanced among

- Risk tolerance
- Financial soundness
- Business viability
- Risk-Return

<u>View (2)</u>
Credit risk appetite prescribes the risk a bank is willing to assume

- Type
- Nature
- Extent

<u>View (3)</u>
Two considerations to determine risk appetite are

- Regulatory requirements
- Business risk-taking

The table below summarizes briefing the regulatory and business perspective in defining risk appetite:

Perspective	Definition	Supported by
Regulatory[21]	A bank's risk appetite describes the level of risk it is willing to take regarding financial capacity, strategic direction, and regulatory constraints (e.g., capital and liquidity requirements).	Risk Capital per statutory requirements
Business	A bank may define risk appetite at the aggregate level and types of risk it is willing to assume within its risk capacity to achieve its strategic objectives and business plan.	Economic Capital to support extra risk assumed for extra return

The Board of Directors is responsible for setting the bank's overall risk appetite statement, recommended by the senior management. The level of detail and sophistication of a bank's risk appetite statement should be commensurate with its business nature and risk management needs. The list below describes the setup process:

- Express the overall risk appetite
- Set out the maximum level of each material risk
- Address quantifiable risks with quantitative measures
- Translate the quantitative measures into risk limits applicable to business units
- Include qualitative statements that articulate the motivations for taking on or avoiding certain types of risks which are less quantifiable in nature
- Include critical background information and assumptions
- Stay forward-looking to include financial targets consistent with the risk appetite.
- Outline the possible measures and actionable elements in response to possible events such as loss of capital or breach in risk limits.

[21] HKMA SPM <u>IC-1 General Risk Management Controls (hkma.gov.hk)</u>

1.2.2.2 Utilize risk management tools

(1) Ongoing monitoring framework

Credit risk monitoring completes the feedback cycle to the management on establishing risk appetite, and risk limit. It indicates the actual credit risk profile in a snapshot. Identifying the root causes of the changes will provide insight to the management regarding implementing banks' risk policies and reviewing the adequacy of the risk mitigation measures. The table below captures the outcomes of an effective credit risk monitoring system:

Definition Credit Monitoring	Objectives Credit Monitoring
Credit monitoring refers to the day-to-day monitoring of the performance of individual credits and the overall portfolio. The monitoring process is carried out at the loan account level by the account officers in the front line and at the portfolio level by the functional units in the back office.	An ongoing monitoring framework ensures that - the account borrowers/counterparties service the credits in compliance with l (T&C) - the credit risk level is within the limits and parameters stipulated in the credit policy - that early warning signals are detected timely for prompt remedial actions - that the performance of the remedial actions is tracked with feedback to relevant parties - that the bank complies with the regulatory limits - that loan provisioning is realistic - That the Credit Committee or senior management can monitor • The overall portfolio quality • The trends • The reassessment of the appropriateness of the credit risk strategy and policy

The tools commonly deployed to manage portfolio risk are:

(2) Risk limits

Exposure limit by type, nature, amount

(3) Risk profile

Risk profile assessment is a point-in-time evaluation of a bank's risk exposure level and type. The assessment includes an evaluation of the bank's material risks, including credit risk.

1.2.2.3 Impacts of external factors

RPs are best to have a system view and be familiar with the update on the economic situation and regulatory environment, how the economy affects different industries, whether the industry is highly cyclical with the economic cycle, what is the business model of the borrowers to leverage the critical business drivers to achieve optimal income and enhance financial strength.

Understanding the above will enable the RPs to exercise judgment on the outlook of the borrower's creditability and look for adequate mitigants for each revealed risk.

(1) <u>Environment scanning</u>

Many banks proactively perform full-scale environment scanning to identify critical economic, industry, and regulatory risk trends relevant for credit risk management. The table below shows examples of environmental scanning:

<table>
<tr><td rowspan="4">Scanning for Changes in External Factors</td><td>Public Health condition</td><td>- 2020 pandemic braked the global economy</td></tr>
<tr><td>Geo-political conditions</td><td>- regional conflicts
- regional wars</td></tr>
<tr><td>Government policies and conditions</td><td>- monetary policy
- fiscal policy
- foreign exchange policy
- government debt policy
- tax and tariff
- foreign direct investment policy</td></tr>
<tr><td>Economic conditions</td><td>- economic cycle
• growth
• rapid growth
• stabilization
• decline
- Inflation rate
- unemployment rate
- economic sector growth
- commodity price
• oil
• crops
- stock market index
- property market index
- banks' competition leading to changes in underwriting criteria</td></tr>
</table>

Scanning for Changes in Industrial Factors	Industry conditions	- industry cycle - cyclical/ countercyclical - government regulations - technology evolvement - environment rules and regulations - energy prices - supply chain switch - entrance hurdles
Scanning for Changes in Internal Factors	Borrowers' situation	- Life stage • start up • growth • rapid growth • plateau • decline - Business model • key business drivers • business strategy to ride on key business drivers - Management quality • management team analysis • via analysis with o SWOT o Canvas - equity/debt financial strategy - sensitivity to the Five Forces • suppliers' power (e.g., reflected in negotiation power) • customers power (e.g., reflected in price sensitivity) • product substitute • competitions (e.g., reflected in market share) • operations

(2) <u>Sources of intelligence</u>

The RPs are responsible for collecting information from various sources of intelligence, including but not limited to:

- Company information
- Public information
- Media data collected by machine and analysed by AI
- Credit rating agency
- Industry network

1.2.2.4 Diversify concentration risk

(1) Strategy of portfolio diversification

Note to trainers: *The credit portfolio diversification strategy to reduce risk is an idea originated from the modern portfolio theory of the 1950s by Nobel Prize Winner Harry Markowitz. The theory states that, given a desired level of risk, an investor can optimize the expected returns of a portfolio through diversification.*

Portfolio diversification is feasible on

- Products (e.g., products with different cyclical cycles)
- Tenor (e.g., yield with different maturities)
- Borrowers (e.g., broaden customer base)
- Counterparties (e.g., expanding counterparties)
- Economic sectors (e.g., economic sectors with different cyclical cycles)
- Geographies (e.g., economic sectors with other geopolitical profiles)

To the extent that diversification would reduce portfolio risk, there is specific/inherent risk in the credit risk portfolio that risk mitigation tactics could address.

(2) Risk mitigant definition

Risk mitigants are sought after to provide a certain comfort level to the credit risk borne by banks. Mitigants reduce uncertainty. Risk mitigants are "comforts" to the identified credit risk.

(3) Risk mitigant types

Risk mitigant is sought at the account level to reduce high-risk application (or renewal, or on demand under stressful situations) to an acceptable risk level.
However, there are principles for risk mitigation:

- A credit application should be able to stand alone without the mitigation
- The borrower's management integrity
- There is one (or multiple) ascertained source of repayment
- There is a second source of repayment
- There are means to preserve the cash flow

(4) Risk mitigant strength

Risk mitigants can be described as strong or weak. The table below provides some examples on the risk mitigants with collaterals and guarantees:

Mitigation	**Quantitative** More quantifiable and rely on 3rd party or secondary source of income, assets, and wealth	**Qualitative** Rely on borrowers; incomes, assets and wealth ascertained by its qualities
Strong mitigation	- Collateral provided by borrower - Insurance policy	
Weak mitigation		- Borrower's business strategy - Borrower's market share

1.2.2.5 Formulate risk mitigation measures

Note to Trainers
Trainers may consider discussing basic measures to protect banks from undue risk exposure. However, the more sophisticated tools[22] is out-scope of the Training Package.

(1) Risk mitigants provided by the borrowers or third parties

The analytical framework below attempts to give some examples of risk mitigation methods:

Means to Identify Risk Mitigants	Type	Risk Mitigation
Understand borrowers' - Incomes - Assets - Wealth	Qualitative	- Pledge of deposits - Secured with collateral - Personal guarantee
Understand borrowers' - Integrity	Qualitative	- Borrowers' reputations on the social media
Understand borrowers' - Five Force Model - SWOT - Canvas business model	Qualitative	- Entrance hurdles - Core competency - Market share
Understand key person's risk - CEO founder	Quantitative	- Key person life insurance
Understand creditors' priority - Seniority on payment	Quantitative	- Can arrange receiving share in priority as senior creditors.
Understand the purposes of the facilities - Seek borrowers to sign comprehensive loan covenants	Qualitative	- Regular repayment - Timely receipt of financial statements - Receipt of growth plan, cash budget - Timely receipt of construction completion report
Analysis, analysis, analysis - Financial ratio analysis - Cash flow analysis - Sensitivity analysis	Quantitative	- Subject to outcomes - Foreign exchange hedging contract

(2) Risk mitigation proactively managed

Portfolio risk mitigation is also achieved with more sophisticated methods, including but not limited to the followings:

- Asset sale
- Securitization
- Credit derivatives

[22] The more sophisticated tools include securitization, insurance, credit derivatives, and others

1.2.2.6 Credit Risk Mitigation Techniques at Right Timing

(1) Identification of needs for risk mitigants

Three risk mitigation moments are: upon credit initiation, during loan life/upon disbursement, and credit renewal. First, an RP identifies the need for risk mitigants after performing a meticulous analysis of the client's creditworthiness during credit initiation. Second, an RP monitors the loan accounts during loan life to detect early warning signals and requests for risk mitigants. Finally, upon credit renewal, an RP reviews the history of the loan accounts and the business outlook. The table immediately below shows examples of noises identified in various units across credit risk management that should be relevant for insight generation. The table below shows how the insights generated above will become feedback for improving the policy, process, and procedures to achieve credit risk management objectives:

Credit Risk Management	Credit Risk Management Related Roles and Responsibilities
Active board and senior management oversight	The Board of Directors' duty and responsibility in credit risk management: - Approving credit strategy and policies - Credit approval and monitoring for large or connected transactions - Delegation of credit authority - Oversight of credit risk management
Credit committee/senior management	The Credit Committee/Senior Management's duty and responsibility in credit risk management: - Credit policy review - Implementing credit strategies and policies - Establishing credit policies and manuals - Credit approval and monitoring within delegated limits - Approving internal credit rating and provisions - Overseeing loan recovery progress
Front office	The Front office is - Credit initiation/appraisal - Credit approval of small limits - Recommending internal credit ratings and provisions - On-going monitoring of individual accounts
Middle office	The Middle office has duties and responsibilities on credit risk management as follows: - Recommending risk management methodology - Limit/exceptions monitoring - Independent credit evaluation/review - Credit approval within delegated limits - Independent review of internal credit
Back office	Checking Credit Approval and documentation - Lien Perfection - Fund Disbursement - Credit file maintenance - Measurement and reporting of credit risk exposure - Collateral valuation
Internal audit and compliance	- Credit audit - Compliance audit

(2) Strong credit risk culture is essential for identification of risk

Enterprise collaboration is essential for adequate credit risk management. A strong credit risk culture enhances the timely identification of needs for risk mitigants. The seamless collaborative effort across credit risk management functions within a strong credit culture is demonstrated in the daily roles and responsibilities in the analytical framework below:

Organizational Units	Board of Directors	Credit Committee	Front Office	Middle Office	Back Office
Enterprise Collaboration to Achieve Four Pillars of Credit Risk Culture					
Establish an appropriate credit risk culture	Approve credit strategies and policies	Implement credit strategies and policies		Portfolio review and analysis	
		Establish credit policies and manuals		Stress-testing	
		Credit policy review			
Enforce prudent procedures for approving credit			Credit initiation/ appraisal	Independent credit evaluation and review	Collateral valuation
	Credit Approval and Monitoring (Large and connected transactions)	Credit approval and monitoring	Credit approval (small limits)	Credit approval (within limits)	Fund Disbursement
Maintain effective systems for credit administration, measuring and monitoring	Decide on risk appetite	Approve internal credit rating and provisions	Recommend internal credit ratings and provisions	Independent review of internal credit rating and provisions	Measurement and reporting of credit risk exposure
			On-going monitoring of individual accounts	Limit/ exceptions monitoring	Credit File maintenance
		Overseeing loan recovery progress		Problem loan workout	Lien perfection

(3) Implementation of risk limit with comprehensive credit policy

Having defined the risk appetite, banks set up risk limits to define the boundaries of risk-taking.

Examples of credit risk policies related to risk mitigation techniques are:

- Policy on collaterals and guarantees
- Policy on asset sale and securitization
- Policy on credit derivatives

The analytical framework below shows regulatory descriptions and practical functions related to the implementation of the risk limits:

	Regulatory Description[23]	**Practical Functions**
Function	To control banks' exposures to various quantifiable risks associated with its business activities - Credit risk - Market risk - Interest rate risk - Liquidity risk	To allocate the aggregated risk-taking mandate to business lines and portoflios
Framework	Set in line with banks' risk appetites to ensure consistency between risk limits and business straegies	The main risk limits are established in banks' risk management policies.
Framework	Set in line with banks' risk appetites to ensure consistency between risk limits and business straegies	The main risk limits are established in banks' risk management policies.
Approval	The Board may wish to approve limits as part of the overall annual budget porcess	The risk limits are approved by the Board of Driectors.
Objectives	Limits should be used to contol different sources of risk concentration: - Arise directly from exposures to borrowers and obligors - Arise indirectly through investments backed by particular asset types - Arise from similar exposures across different business activities	The limit system sets boundaries for the accepted level of credit, market, liquidity and operational risk within the established risk appeteite.
Scaling	Risk limits should be suitable for the size and complexity of a banks' business activities and compatible with the sophistication of its products and services and should not merely seek to meet the minimum regulatory requirements or the general market practices.	
Risk Limit	Risk limits should be set at various levels: e.g., Individual business lines, business units, the business entity, the business group	
Documen-tation	Banks should have a clearly documented methodology for allocating overall risk limits across business lines and unites.	
Review	Limits are subject to regular review and are reassessed in the light of changes in market conditions or business strategies.	

[23] HKMA SPM IC-1 General Risk Management Controls (hkma.gov.hk)

Education	Risk limits should be clearly communicated to the business units and understaood by the relevant staff.	
Monitoring	Limit utilization should be closely monitored. Any excesses or exceptions should be reported promptly to the Chief Risk Officer and the senior management for necessary action.	

<u>(4) Check and balance on the risk-return</u>

With risk appetite established, banks would choose the exposures that give returns commensurate with the risk it has assumed. The credit policies contain the scopes, the risk limits, and the profit target to ensure the credit applications fulfil the risk and return balance at the loan initiation and review stages. The table below shows some of the application examples:

Scope	Limits Serve as Guidance to	Exposure Limit	Profitability Target
Target market	- Capture opportunities in the market where the bank has an appetite for - Have strategies and products developed per the market needs and opportunities	X	X
Minimum credit standard	- Accept only the credit applications which meet the minimum requirements (Usually, only a rating of "1" would be accepted. If the identified risk from an applicant is lower than "1", the bank would explore risk mitigation measures with the applicant to lower the risk level)	X	X
Sectors	- Draw attention to the economic sectors at different stages from "start-up," "growth," "rapid growth," "maturity," "Stagnation," and "Decline" - Manage the exposure by counterparties in various economic sectors (e.g., public sectors, local government sectors, others)	X	X
Products	- Develop products in line with the market risk appetite and the bank's risk appetite, minimum credit standards, and sectors	X	X

1.2.3 Identify Needs for Risk Mitigants

1.2.3.1 Quantified Risk Level Trends for Critical Factors

(1) Quantified risk appetite

Each bank develops its risk appetite statement according to the regulatory requirements, the strategic business direction, and capital and cash constraints. The risk appetite metrics/dashboard, therefore, is also varied. There are suitable academic materials available on the subject[24]. The table below shows some of the potential metrics:

Risk Type	Metric	Risk Tolerance Range
Strategic	ROE	e.g., 10% - 15%
	New Loan Growth	e.g., 5% - 5% per quarter
Credit, market, and liquidity	% Loan delinquency (30 days +)	0.5% - 1.9%
	Credit Concentration	<15%
Operations	% Of high-risk operational control issues	<10%
	Operational Losses as % of Total Revenue	<1%
Compliance	% Of high severity compliance issues	0
Reputational	% Retention of High-Potential Key Manager	>80%

(2) Credit risk strategy alignment with credit risk objective

Having stipulated the risk appetite, banks align credit risk strategies and credit risk objectives. Banks should thoroughly consider one’s situation, review the goals, and adopt a realistic strategy. A simple or sophisticated approach toward portfolio management depends on the needs and resources of the bank, which selects the adequate portfolio management accordingly.

[24] Implementing an effective risk appetite, James Lam, IMA, Aug 2015, 8150b134bafd42aaaf5267bf49d6d2a3.ashx (imanet.org)

<u>(3) Credit risk appetite statement translated into credit criteria on loan application and review</u>

Credit risk appetite is about setting boundaries around the banks' activities. That could take setting limits for business divisions, geographical regions, industries, products, top customers, and other customers based on their risk grades. The table below shows some examples of the credit risk appetite meant to be aligned with the bank's risk appetite metrics:

Target Market	**Underwriting Criteria (Minimum Credit Standard)**	**Sectors**	**Products**
- Geography - Sector - Industry - Products	- Exposure at Risk - Internal Risk Rating - Tenor - Purpose of the credit - Type of credit facilities - Capacity to borrow - Security - Repayment capability (Cash flow analysis, Sensitivity analysis) - Profitability - Terms, Conditions	- Growth Stage - Rapid Growth Stage	- Developed in line with target markets

(4) Alignment of portfolio performance indicators with the risk appetite metric

The analytical framework below shows examples of how banks' considerations define the portfolio boundaries per credit risk appetites:

<table>
<tr><td rowspan="5">Credit Risk Appetite Metric</td><th colspan="2">Portfolio Boundary</th></tr>
<tr><td>Target market
- Geography
- Sector
- Industry
- Products</td><td>Target market boundary
- Geography exposure limit
- Sector exposure limit
- Industry exposure limit
- Product exposure limit</td></tr>
<tr><td>Underwriting criteria
- Exposure at Risk
- Internal Risk Rating
- Tenor
- Purpose of the credit
- Type of credit facilities
- Capacity to borrow
- Security
- Repayment capability
- Profitability
- Terms, Conditions</td><td>Underwriting boundary
- Ceiling
- Credit Risk Rating
- Maximum Tenor
- Working Capital, Project Finance, Commodity Finance, etc.
- Collateral, guarantees
- Cash flow analysis, sensitivity analysis, NPV, IRR
- Return on risk-adjusted capital Based Pricing</td></tr>
<tr><td>Sector
- Growth Stage
- Rapid Growth Stage</td><td>Sector
- Exposure limit
- Exposure limit</td></tr>
<tr><td>Product
- Developed in line with target markets</td><td>Product
- Exposure limit</td></tr>
</table>

(5) Portfolio indicators for senior management's reference

The RPs should be familiar with the implications of the portfolio credit risk indicators to senior management and try to obtain relevant insight by asking strategic questions. The table below shows examples of credit risk indicators:

Credit Risk Indicators	Default Risk	Exposure Amount	Recovery Rate	Liquidity	Set the Boundary
Aggregate exposure versus portfolio limit - by industry - by country - by product - by type of counterparty • Banks • Non-bank financial institutions • Corporates • Retail customers		✓			✓
Total portfolio - by internal credit rating and trend		✓			✓
Total exposure - by groups of related countries		✓			✓
Large exposures		✓			
Connected lending		✓			
Loan-to-value ratio - asset-based lending with loan-to-value ratios exceeding pre-set limits (e.g., mortgages with loan-to-value ratios exceeding 70%)			✓		
Ageing - overdue accounts with ageing analysis (i.e., amounts overdue one, three, six months etc.)	✓				

Risk migration - credit downgrades and loans rescheduled during the period	✓				
Interest payment - interest suspended	✓				
Loan Provisioning - adequacy of provisions	✓				
Expiry - facilities expiring soon	✓				
Undrawn Commitment - undrawn commitment ratio (i.e., undrawn facility amounts as a percentage of total facilities				✓	
LTV - loan-to-deposit ratio				✓	
Outcomes of stress-testing - policy or limit amendments - hedging - exposure reduction (e.g., through asset sales, securitization, etc.) - contingency planning for actions to be taken should a particular scenario happen	✓				

1.2.4 Identify the relationship of risk level change with loan provision

1.2.4.1 Exposure approaching or exceeding limit

<u>The trainer's and guest specialists' sharing in seminar during the class:</u> **Trainers will update the latest development on loan classifications, providing rules and regulations, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.**

(1) <u>Regular review of risk level change</u>

Continuous review of the risk level change to identify corresponding mitigation is an essential credit risk management process. RPs should evaluate the forecasting and review approach to recommend possible improvements in risk rating assessment to enhance loan provisioning quality further.

(2) <u>Credit risk mitigation and loan provisioning</u>

Credit Risk Mitigation Techniques protect banks' interests and, at the same time, effectively mitigate the risk exposure. The risk mitigation, under some circumstances, lowers the loan provisioning. The table below shows an example:

Example

For the purposes of the HKMA's loan classification system, security refers to

- Tangible assets such as cash, properties, and securities
- Guarantees issued by a Central Government or Central Bank of a country without payment difficulties, an authorized institution or an overseas bank which is under adequate supervision

Determination of the lesser provision

- The value of tangible security means its net realizable value, being the current market value of the security less any realization costs
- Market value should be measured based on up-to-date valuation and is defined in terms of the price at which an asset might be sold at the valuation date assuming:
  - A willing buyer and seller
  - Transaction is at arm's length
  - A reasonable period has been allowed for the sale; and d) the asset is freely exposed to the market

(3) IFRS9 management implication in portfolio risk management[25]

The IFRS9 has impact on the risk mitigation strategy. The analytical framework below shows some examples of preventing migration of credit risk rating and mitigation actions when migration happens:

Measures To Prevent Migration of Credit Risk Rating	**Measures to Mitigate Portfolio Risk when Migration Occurs**
- Validate / Redefine portfolio mix and risk appetite considering: • Steer commercial focuses on the more resilient sector throughout the economic cycle • Stress cost opportunity for the origination of longer-term products or uncollateralized exposures - Evaluate higher-risk clients to limit their potential migration - Implement management dashboards to • Closely monitor watch lists and early warning signals • Anticipate migration and • Implement remediation actions - Derive loan origination policies and structure trigger company actions and contingency plans if specific pre-defined credit deteriorating scenarios are met - Create new formal loan classification criteria for loans with a high migration risk to apply risk management, including higher provision levels that reduce sharp deterioration if transition materializes	- Accelerate measures and processes that promote sustainable debtor capacity for repayment - Establish automated flags and MIS to reduce time to cure the client's situations - Set efficient timelines for the restructuring process and accelerate triggers of recovery/contingency actions for exposures - Promote solutions in clients with potential injection of fresh money - Implement clear and effective hand-over policies among management units, such as workflow management tools to support the overall recovery strategy

[25] Research by Alvarez & Marsal, IFRS impacts the credit risk management strategy.

1.2.5 Identify key regulations[26], report remedy and make recommendation

The trainer's and guest specialists' sharing in seminar during the class: **Trainers will update the latest development on key regulations updates, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of banks. The seminar can take place as the last session of the class.**

1.2.5.1 Evaluate credit strategy for management approach

(1) Large exposure and concentration

While banks define their risk tolerance, risk appetite, risk limits, and risk profile, they need to refer to some principles stipulated in the regulations, considerable exposure, and concentration risks. The table below summarizes banks' practices to establish limits on various kinds of risk concentration:

Various Kinds of Risk Concentration	A Bank Should Carefully Manage and Avoid Excessive Risk Concentration
- Large exposure to individuals[27], in particular exposure exceeding 10% of the bank's capital base	- Establish limit on the individuals
- Large exposure to groups of borrowers with similar • Entity characteristics • Economic sector • Geographical sector	- Establish limit on similar borrowers
- Large exposure in relation to facilities exceeding 10% of the capital base (Notwithstanding the 25% limit on large exposures under SS 81 of the Banking Ordinance.	- Establish limit on facilities
- Concentration on types of lending with similar • Characteristics • Tenor • Pricing • Repayment	- Establish limits on lending with similar risk characteristics
- Inter-dependencies leading to contagion effects e.g., stock market price impact on default rate e.g., property price impact on default rate	- Analyse the portfolio intelligently to identify the inter-dependencies e.g., correlation analyses e.g., sensitivity analyses

[26] Return of Capital Adequacy Ratio, Part IIIb – Risk-Weighted Amount for Credit Risk Standardized (Credit Risk Approach) Form MA(BS)3(IIIb), Microsoft Word - CI - part IIIb.doc (hkma.gov.hk)
[27] HKMA guidelines on personal loans, for example, Our Ref (hkma.gov.hk)

- Collaterals and guarantees	- Avoid over-reliance on collateral or guarantees. The primary consideration should be borrowers' debt-servicing capacity: • Establish limit on the same type of collaterals • Establish limit on the financial securities from the same issuer • Establish limit on the financial securities from the same market • Establish limit on the guarantee from the same guarantors
- Business with companies in the internet sector	- Make the decision based on sound banking principles and a bank should not be swayed by what's fashionable
- Extension of credit to asset-dependent sectors e.g., stock markets e.g., property markets which may leave a bank unduly exposed to a collapse in asset prices with consequent increased defaults by debtors	- Manage carefully and avoid excessive risk concentration
- Mismatch of funding, where long-term domestic lending is financed by short term external borrowing e.g., reversal of capital flows can lead to a liquidity squeeze and exposure to possible adverse exchange rate movements.	- Establish prudent mismatch limits to control such risks.

(2) Breach on large exposure exceeding regulatory limits[28]

The large exposure of the portfolio must be closely monitored at all times from loan inception and throughout the loan life, as there is consequence of breaching the compliance requirement **(Cap.155S).**

Example (1) Consequence of failure to comply with a prescribed notification requirement or remedial action

- This is an offence. The person charged is to prove that he took reasonable precautions and exercised due diligence to avoid committing such an offence by himself or any person under his control.
- The bank itself and every director, every chief executive and every manager of the bank are liable to penalties such as fine and imprisonment.

The breach of statutory limits under the BELR may indicate that the HKMA will consider whether the HKMA's power to revoke the authorization of the bank is exercisable and if so, whether it should be exercised because

- The bank does not have adequate systems of control to ensure the specified limit within limit
- The bank does not carry out its business in a prudent manner

Example (2) Consequence of failure to comply with a prescribed notification requirement or remedial action

The HKMA may consider taking other appropriate actions such as

- Increase the bank's minimum capital adequacy ratio
- Limit the bank's business expansion

Example (3) Consequence of failure to comply with a prescribed notification requirement or remedial action

The bank will agree a timetable to bring the exposure quickly below the statutory limit or any agreed limit and to report progress on a regular basis.

[28] Hong Kong Monetary Authority - Exposure Limits (hkma.gov.hk)

1.2.5.2 Review mitigation results for suggestions

(1) Balance sheet exposures

There is regular reporting on banks' exposures. The table below shows the examples on the quarterly reporting on exposure by category:

Class I	Sovereign exposures	Class VII	Collective investment scheme exposures
Class II	Public sector entity exposures	Class VIII	Cash items
Class III	Multilateral development Bank exposures	Class IX	Regulatory retail exposures
Class IV	Bank exposures	Class X	Residential mortgage loans
Class V	Securities firm exposures	Class XI	Other exposures which are not past due exposures
Class VI	Corporate exposures	Class XII	Past due exposures

(2) Risk weighting

The risk-weight for an exposure under any of Classes I, II, IV to VII is determined based on its credit assessment rating assigned by an external credit assessment institution (ECAI) recognized by the HKMA. Each of these six ECAI ratings-based portfolios has its own risk-weighting framework under which risk-weights are mapped to a scale of Credit Quality Grades represented by the numerals 1,2,3,4,5 or 6, as the case may be.

Appendix – Risk Appetite Conception and Statement

Risk appetite conception[29]:
Refer to the sample link in the footnote, a bank conceives risk appetite with all-rounded consideration: regulatory, strategy and capital planning. Its Board should thoroughly understand the bank's current risk position relative to its risk appetite and how the position would be changed if the risk appetite was changed. In this regard, stress tests may be used to generate a dynamic view of the bank's capital and risk positions.

Example of risk appetite statement

With a clear understanding on the risk tolerance capacity, a bank drafts the risk appetite statement which is a written articulation of a bank's risk-taking, risk mitigation and risk avoidance, taking into consideration the banks' statutory requirements. It contains risk category-specific statements and forms a tool for the Board of Directors and senior management to guide and monitor the bank's risk-taking activities.

Note to trainers
There are banks which publish the risk appetite conception process and the risk appetite statement at high level.

Requirements on risk appetite statement
There is no standard way of expressing risk appetite. However, there are some requirements set by the HKMA in certain areas. The table below shows some of the examples:

Requirements	Description
Approval	By the Board on any changes
Risk targets	All relevant risks of the bank be taken into account - Those that could be quantified - Those that are more difficult to quantify All relevant risk - On-balance sheet transactions - Off-balance sheet transactions Consistent with one another risk Consistent with the bank's - Nature - Complexity of business
Scope	Reflect a suitably wide range of measures and actionable elements
Consistency	Clearly articulate the bank's intended responses to a range of possible events e.g., a loss of capital, e.g., a breach in risk limits
Reality check	Management actions documented in the statements should be realistic and feasible for - Restoring capital - Reducing risk in adverse situations
Monitoring	Robust procedures and controls are in place for - Setting the risk appetite - Monitoring the risk appetite
Principle	Prudent approach

[29] Risk Appetite Statement (nib.int), Risk Appetite Statement, Nordic Bank

1.3 Submodule 3: Manage and Control the Risks

Note to trainers
Trainers can pick, change, and repackage the content sample below according to learners' needs

1.3.1 Introduction

Submodule 2 has introduced various risk mitigation techniques and measures to reduce banks' credit risk exposures. Despite all these techniques, however, some banks have decided to concentrate on specifically chosen portfolios in which they have cumulated expertise in risk management.

The HKMA released research in 2018 that said: "The net effect of sectoral loan concentration on the credit risk of banks, which is a question that remains inconclusive in banking research due to the potential trade-off between concentration risk and specialization gain.

While some concentration risks are common to the local banking industry and cannot be avoided, they can be managed by adopting proper risk control and diversification strategies. Therefore, safeguarding against risk concentrations should form an essential competence of banks' risk management system.

1.3.2 Monitoring portfolio – theory and practice

1.3.2.1 Manage risk of credit assets

Note to trainers

RPs should be familiar with the bank's risk tolerance, risk appetite, risk limit, and risk profile (through credit risk monitoring). However, RPs also have to manage two credit risks that are not direct observation through account level risk monitoring, namely, the contagion risk and the risk of collaterals and guarantees. Understanding the above enables RPs to exercise sound judgment on whether a credit transaction fits the bank's risk strategy and to arrange adequate risk mitigants to prevent undue credit risk.

(1) Risk exposure

The amount exposed to credit risk is exposure risk. Exposure includes any risk pertinent to the default of a counterparty:

- All exposures that require capital under the Capital Rules
- All exposures on- or off-balance sheet
- All exposure to trading books or banking book
- Indirect exposure to a credit protection provider
- The exposure of collateral, if its value is recognized in the calculation of the counterparty credit risk

(2) Concentration risk

Risk concentration can be viewed as any exposure with the potential to produce substantial losses to threaten banks' capital strength or earnings or otherwise undermine public confidence in the bank.[30] The table below lists out some related examples:

Additional Resources for Trainers:

The HKMA pointed out in its research articles that concentration risk presents the two sides of the same blade. Unbalanced portfolio structure was the culprit of several significant bank crises in the past. The table below lists out some of the classic cases.

Case	Bank	Country for Reference	Years
1	Lehman Brothers	USA	2000s
2	Barings Bank	UK	1990s
3	Bank Bumiputra (Carrian Group Case in HK)	Malaysia	1980s

(3) Assuming concentration risk

BIS[31] pointed out that limit systems often do not capture concentration risk that arises from distinct but correlated exposures. Besides, limits are often decided on the basis of a variety of business considerations and strategic objectives, of which controlling concentration risk is only one aspect.

[30] Refer to Section G Subsection 3.1 for HKMA SPM CR-G-8 Large Exposures and Risk Concentrations

[31] Studies on credit risk concentration (An overview of the issues and a synopsis of the results from the research Task Force project), Working Paper No. 15, November 2006, Basel Committee on Banking Supervisor. Studies on credit risk concentration: an overview of the issues and a synopsis of the results from the Research Task Force project - November 2006 (bis.org)

(4) Direct limit on concentration

The analytical framework below shows examples of concentration risks controlled by exposure limits:

Risk	Description	Examples	Causes And Sources of Risk	Cases With Valuable Lessons Learned
Large exposure	At individual counterparty	Single name exposure	Single customer concentration exceeds economic capital	Carrian Group and Bank Bumiputra
	In groups of linked counterparties	Linked counterparties exposures	The financial situation of one company affects that of one or more in the linked counterparties	Bank Bumiputra in Carrian Group Case
Sector exposure	In specific economic/ industry sectors	Shipping industry Aviation industry Retail industry Real estate industry Construction materials industry	Highly cyclical	Cyclical downturn during COVID19 outbreak since 2020
Sovereign exposure	In specific geographical locations	Local government granting credit facilities to large property developers	Political instability	Russia's situation[32]
Tenor	Concentration of maturities	A bank having liquidity shortage to meet highly concentrated maturities	Should carefully manage the maturity schedules	
Funding	Short-term debt to fund long term purpose	A balance between asset maturity and liability maturity not maintained	Difficulty to roll over short term funding	
Foreign currency	Foreign currency debt repaid by local currency incomes	A bank borrows long-term in foreign currency to fund short-term loan.	Sovereign monetary policy change	Dramatic decline in exchange rate of Korean Won in 1997s

[32] Bloomberg news, April 9, 2022, Russia's First Default in a Century Looks All But Inevitable Now - Bloomberg

(5) Contagion risk from concentration

The table below shows the various forms of contagion risk:

<table>
<tr><th>Forms Of Contagion Risk</th><th>Description</th><th>Examples</th><th>RPs To Exercise Extra Care In</th></tr>
<tr><td>Correlation of countries</td><td>Adverse development in a particular country may have effect on other countries that have a close economic linkage with it</td><td>War in Ukraine might have been related to high inflation due to food price increase.</td><td>Adverse development in major countries which are parts of essential supply chains</td></tr>
<tr><td>Correlation of sectors</td><td>Financial problem in a particular industry may have effect on other industries that have a close economic linkage with it</td><td rowspan="2"><u>Positively Correlated</u>
- Real Estate Development
- Construction materials

<u>Negatively Correlated</u>
- Healthcare industry
- Retail industry

As a general rule, negative correlation is better than positive correlation in the portfolio.</td><td>The correlations of accounts and portfolios that vary over business cycles and across firms</td></tr>
<tr><td>Correlation of defaults</td><td>One default case may have effect on the other seemingly regular cases</td><td>The correlations among borrower’s default circumstances</td></tr>
</table>

(6) Concentration risk on collateral

As risk mitigation measures, banks will have the borrowers secure wholly or partially a loan. When a preference for similar collaterals cumulates, other credit asset concentration risk arises. The table below shows one example:

Forms of Concentration Risk	Description	Examples	Sources and Causes of Risk
Collateral	Collateral in land or share	Correlation between collateral in land/properties from Real Estate Industry	Cyclical

(7) Principles of controlling risk concentration

The table below lists out some of the principles of controlling risk concentration:

Situations	Principles	Elaboration
All	Manage concentration risk Avoid excessive risk concentration	e.g., exposure to individual counterparties e.g., exposure to groups of counterparties with similar risk characteristics e.g., exposure to economic sector e.g., exposure to geographical sectors e.g., exposure to types of lending with similar characteristics - Property Lending - Taxi Loan
All	Exercise care to avoid exposures not subject to statutory limit	
All	Ensure that prudent credit granting criteria are met	e.g., extension of large credit facilities exceeding 10% of a bank's Tier 1 capital
Internal risk rating	Ensure that the internal rating system in use is commensurate with the nature, size, and complexity of banks	e.g., internal ratings are assigned to individual counterparties as a basis for setting internal exposure limits for those counterparties
Statutory limit	Understand that the statutory limits are not necessarily indicative of the level of risks to take	e.g., statutory limit of 25% does not mean that as high a level of exposure as this is appropriate for a particular counterparty or a particular bank
Statutory limit	Ensure that prudent credit granting criteria are met	e.g., extension of large credit facilities exceeding 10% of a bank's Tier 1 capital
Collateral	Avoid undue reliance on collaterals, guarantees, and credit derivative contracts	e.g., collaterals/guarantees to support large exposure, as reduction of exposure does not imply that the excess risk on credit risk mitigation covered exposure is eliminated
Counter-Party	Ensure that level of exposure is commensurate with that	e.g., exempted exposure e.g., exposure covered by credit risk mitigation

	counterparty's financial strength and creditworthiness	
Group of linked counterparties	Capture, ideally, all parties linked in such a way that the financial strength of any of them may affect that of the others	e.g., a bank may choose to apply linking by economic dependence
Other risks	Monitor and control other risk adequately	e.g., legal risk, operational risk, market risk
Stress scenarios	Conduct stress-testing and scenario analysis to assess the potential losses arising from changes in economic cycles, interest rates, market movements and liquidity conditions.	Refer to Submodule 1.5 for Stress Testing

Align Risk Management Strategies with Banks' Strategies on complex products and borrowers' structure

(1) Portfolio risk control

The desirable risk profile is documented and communicated via various credit policies. A credit risk policy guides a bank's management regarding adequate business development. The credit risk policy indicates and embeds a bank's tolerance with the expression of various limits on the credit asset portfolios. Among other limitations, credit policies must include the risk tolerance indicators/maximum/ceiling. Furthermore, for some risk tolerance levels, there are regulatory requirements. The desirable risk profile is documented and communicated via various credit policies.

A credit risk policy guides a bank's management regarding adequate business development. The credit risk policy indicates and embeds a bank's tolerance with the expression of various limits on the credit asset portfolios. Among other limitations, credit policy must include the risk tolerance indicators/maximum/ceiling. Furthermore, for some risk tolerance levels, there are regulatory requirements.

Examples of credit risk policy

- Credit Risk Policy – Large Exposure and Risk Concentration
- Credit Risk Policy – Loans and Credit Facilities
- Credit Risk Policy – Collaterals and Guarantees
- Credit Risk Policy – Loan Provisioning
- Credit Risk Policy – Derivatives
- Credit Risk Policy – Mitigation Techniques

(2) Quality credit risk policy[33]

- The credit risk policy should follow the principles of prudence.
- A credit policy should not be relaxed because of competitive pressures.
- The credit risk policy should be enforced and applied consistently.
- The credit facilities are for credit-worthy customers.
- Banks should avoid risk concentrations.

[33] Refer to Section G Subsection 3.1 for HKMA SPM CR-G-1 General Principles of Credit Risk Management

- Locally incorporated banks with overseas branches should establish credit policies adapted to local conditions.
- All relevant employees need to be aware of the credit risk policies. They should understand the credit policies and apply them at the consolidated and individual subsidiaries' levels.

(3) Keep abreast of regulatory requirement both locally and cross-border-wise

Each bank has a written statement of its credit risk strategy and policy which should be consistent with its risk appetite, level of capital available for credit activities and credit management expertise. Each bank should keep abreast of regulatory requirement both locally and cross-border-wise.

The table below shows a sample outline of credit policy – large exposure and concentration:

Sample Outline of Credit Policy **The policy should include a minimum as in the following. In addition, the policy would have variations for banks with different business natures and scales.** **Policy Outline** • **Definition**: The definition of exposure • **LC**: Use criteria for identifying a group of linked counterparties • **Limit:** The individual and aggregate exposure limits for various types of counterparties. The 25% statutory limit under Rule 44 (1) should not necessarily be considered the maximum limit for counterparty exposures. • **Limit:** The aggregate maximum exposure limits for industry, an economic sector, a country, a region, or a group of borrowers which have a similar or homogeneous risk. • **Limit:** Set the internal limits on both a solo and a consolidated basis • **Exceed limit**: When exceeding the limit, the party authorizing the excesses is: e.g., the bank's Board of Directors or Credit Committee with delegated authority from the Board. • **Authority**: The delegation of credit authority within the bank for approving significant exposures • **Secured and non-secured:** No risks are free. Document any differentiation between the limits for secure and unsecured exposures. • **Clustering limit:** The clustering limit (the maximum amount of aggregate non-exempt, non-bank significant exposures, in terms of amount or percentage of the bank's Tier 1 capital, which may exist at any time. • **Procedures:** The procedures for identifying, reviewing, monitoring, and controlling significant exposures • **Report**: The allocation of responsibility for reporting large exposures to the HKMA and ensuring compliance with the Banking (Exposure Limit) Rules (BELR) Part XV of the Banking Ordinance (BO) (e.g., SS81B) and other prudential obligations concerns concentration risk.

1.3.2.2 Measures to Diversify Risk

(1) Risk diversification approaches – simple versus statistical

The table below compares the two methods of credit risk diversification:

Simple and Straight Forward Diversification	Sophisticated and Statistical Method
- Increasing the number of borrowers with smaller loan sizes to form a portfolio of the same amount (before diversification) helps to lower the portfolio risk	- Analyse the credit risk profile of accounts in a portfolio to identify the ones with correlations - Study the risk profiles of typical uncorrelated or less correlated accounts - Fine-tune the credit policies to accommodate the updated desirable borrower's risk profile

(2) Credit risk mitigation – traditional versus portfolio approach

The table below compares the two approaches of credit risk diversification:

	Portfolio Approach	Traditional Approach
Pros and cons	Highly efficient but imperfect credit portfolio behaviours may affect outcomes of analysis	Intuitive, but require RPs to cumulate experience to make the intuitive judgment
Endorsement	The portfolio approach of credit risk is one of the central themes of the BASEL Accords.	Endorsed by the Board of Directors
Focus	Correlations between portfolios	Focus on reducing the concentration risk by dispersing the portfolio among as many variables as possible so that a large and diversified portfolio is obtained
Method	Based on Markowitz's portfolio section theory	Diversify across borrowers' - Name - Sector - Industry - Geography - Countries - Product
Decision	Mathematical	Based on "Intuition," "Experience," and "Expertise"
Compensation to the traditional model	Behavioural patterns Covariance among - Sector - Industry	Traditional model coupled with application of simple information technology might result in longer

	- Geography - Countries - Products Portfolio analysis	turnaround time to understand the behavioural patterns
Loophole	Past data analysis Risk measured by volatility (standard deviation) which may not be agreed by risk management veteran Correction assumed to be fixed and constant	Correlation between homogeneous groups is not clearly visible
Constraints	Credit assets with higher default risk will "dominate" the negative correlation between portfolios.	

(3) Credit risk diversification has limitation

Credit risk diversification is possible to a certain extent only. The analytical framework below shows some examples of the limitations:

Risk Type	Description	Nature	Lessons Learned
Systematic risk	External factors which impact all portfolios. e.g., economic factors e.g., sovereign factors	Cannot be eliminated by combining assets to become a very "diversified" portfolio	2008 US Sub-prime crisis 1997 Fast East Asian Crisis
Unsystematic/ diversifiable risk Concentration risk - Country - Region - Sector - Industry - Collateral - Currency - Counterparty - Tenor - Funding source	Industry risk factors Company risk factors	Can be reduced with adding assets with negative correlations into the portfolio	Adequate underwriting criteria to select successful application based on bank's risk appetites

1.3.2.3 Mitigate Credit Risk

(1) Security and third-party guarantee

The financial strength and payment capability is the primary consideration of a credit offer. The collateral and guarantees are a secondary source of repayment and other purposes. The analytical framework below shows some examples:

Purpose	Collaterals	Guarantees
Risk Mitigation (Exposure Reduction)	Secondary source of repayment upon booking	Secondary source of repayment upon booking
Loss Reduction (Gain control of title)	Primary source of repayment upon default event	Primary source of repayment upon default event
Early Warning Signals	Indicate borrowers' deteriorating repayment ability (e.g., mark-to-market in margin financing)	Default incidence of guarantor in another bank
Eligible for applying lower capital risk weight to credits secured by collaterals	Possible	Non-applicable

(2) Insurance

Credit insurance is exclusive to protecting trade receivables. It covers a company against the risk of not being paid by the customers after a sale. For most borrowers, the largest single current asset is trade receivables. Therefore, credit insurance coverage is one of the means to protect the borrowers' earnings.

(3) Other risk management measures and their limitations

There are other risk management measures, including but not limited to the following strategy:

- Asset Sales
- Asset Securitization
- Credit Derivatives

RPs should be familiar with the BIS Principles on controlling residual risk using the above measures.

Asset sales, asset securitization and credit derivatives

- **Experts required**

  Asset sales, asset securitization, and credit derivatives are more sophisticated methods of portfolio risk management. The operationalization of these risk management measures requires a designated taskforce/team with skilled RPs, and legal, accounting, and treasury experts. In addition, the Credit Risk Committee and Senior Management must understand the measures' end-to-end process and risk management for approval.

- **Limitations to consider when choosing credit risk mitigation techniques**

  In controlling the risk of a credit portfolio, banks need to consider both available instruments in the markets and the limitation of the risk management measures for consideration. The table below shows a sample summary:

Limitations for Considerations[34]	Examples of Instruments
The bank's own knowledge and experience in such techniques	- Collaterals with priority claims - Standby letter of credit - Guarantees by third party - Netting agreements against deposits from the same counterparty - Set strict loan covenants - Credit derivatives and other hedging instrument
Cost-effectiveness	
Types and financial strength of the counterparties	
Types and financial strength of the issuers	
Correlation with the underlying credits	
Availability, liquidity and realizability of the credit mitigation instrument	
The extent to which legally recognized documentation can be adopted	

Residual risk monitoring[35]

While using Credit Risk Mitigation techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity, and market risks.

Examples on managing residual risk in legal area – legal certainty

- For banks to obtain capital relief for any credit mitigation techniques, they must fulfil the conditions. Firstly, all documentation of collateralized transactions must be available. Secondly, documentation of on-balance sheet netting, guarantees, and credit derivatives must be binding on all parties and legally enforceable in all relevant jurisdictions.
- Banks must have conducted the sufficient legal review to verify the above have a well-founded legal basis to reach this conclusion and undertake further review necessary to ensure continuing enforceability.

[34] Refer to Section G Subsection 3.1 for HKMA SPM CR-G-1 General Principles of Credit Risk Management
[35] Section 22.6, https://www.bis.org/basel_framework/chapter/CRE/22.htm

(4) BIS principles on controlling residual risk and hedging maturity mismatch

The BIS advocates that banks should adequately control the residual risk, resulting in the reduction or transfer of credit risk. If these risks are not sufficiently controlled, banks may be imposed additional capital charges or take other supervisory actions.

Note to trainers: Trainers may consider sharing the lessons learned from AIG in the class and prepare long questions or case-based questions based on simulated scenarios.
Link for reference only: What Went Wrong at AIG? (northwestern.edu)

Note to trainers: Trainers may alert learners that a maturity mismatch[36] occurs when the residual maturity of a hedge is less than that of the underlying exposure. Hedges with maturity mismatches are only recognised when their original maturities are greater than or equal to one year. Maturity of hedges for exposures with original maturities of less than one year must be matched to be recognised. In all cases, hedges with maturity mismatches will no longer be recognised when they have a residual maturity of three months or less.

(5) Credit risk exit strategy

Banks should have strategies to assume credit risk and exit from existing credit risk. As credit risk diversification has a limit, transfer of credit risk would be the alternative to control/reduce risk.

(6) New product launch[37]

Upon every new product launch, representatives of the credit risk management system will ensure the proposed credit guidelines have considered CAMEL risk factors and their risk mitigation. In addition, launching adequate new products will add revenue and new correlations to the portfolio. At the same time, understanding the correlation of the new product with the existing portfolio is essential. The table below is a brief summary of the considerations on new products' risk:

Types of Risk Related to New Product	Practice
RPs should be alert when new products with different risk characteristics than the products in the existing portfolio are introduced for consideration.	- Ensure that the Board of Directors understand the risks fully. - Conduct formal risk assessment of the product and activities - Establish, duly approved as appropriate • Credit policy • Credit procedures • Credit controls

[36] Section 22.97 & 22.99, https://www.bis.org/basel_framework/chapter/CRE/22.htm
[37] Refer to Section G Subsection 3.1 for HKMA SPM CR-G-1 General Principles of Credit Risk Management

1.3.2.4 Identify risk factors for quantification

(1) Acceptance criteria and factors affecting the value of the credit assets for purchasing and selling to quantify the risk

Banks can achieve proper risk monitoring and control of the concentration risk in collaterals with the relevant credit risk policy spelling out the acceptance criteria regarding collaterals. The table below is an example of the policy outline:

Credit Policy	Acceptance Criteria on Collaterals	
Market	Readily available secondary market	
Repossession	Legally enforceable and without impediment	
Price	Determinable market value; OR Reasonably established and Verifiable	
Secure control	Movable asset - Take physical custody (Gold, precious metal, taxi medallion) - Means to locate (Machine, equipment, vehicle) - Must have expertise to manage - Must have system to manage	
Expertise and System	Must have expertise to manage	Must have system to mange
Term of validity	Aligned with the term of the underlying obligations which it secures	
Caution	Collaterals with material positive correlation with the credit quality of borrowers.	- Shares of borrowers - Shares of borrowers' related company
LTV	List of acceptable collaterals	Maximum loan-to-value

(2) Portfolio control on guarantee

Proper risk monitoring and control of the guarantees are achieved with the relevant credit risk policies which spell out the acceptance criteria regarding collaterals. The table below shows an example of the policy outline:

Credit Policy	Acceptance Criteria of Guarantees	
Title	Direct claim on the guarantor	
Condition	Unconditional and irrevocable	
Legal	Legally enforceable with proper documentation	
Term of validity	Aligned with the term of the underlying obligations which it secures	
Financial strength of the guarantor	Thoroughly assess the financial strengths as "adequate for discharging the obligation under the guarantee"	- Not linked to the borrower - Not affected by the financial position of the borrower - The financial strength is reviewed during the annual credit review
Nature of the underlying loan	Unsecured	Except if guarantee issued by - Central governments - Central banks - Banks - Oversales incorporated banks Under adequate supervision with repayment capability

(3) Portfolio control on collaterals and risk mitigation

Credit risk control and monitoring of collaterals' value enables timely remedial actions taken on the impact of contagion risk. Credit risk mitigation techniques protect the banks' interest and, at the same time, effectively reduce the risk-weighted amount. The table below shows some examples of mitigation measures embedded in credit policy:

Risk	Sources and Causes	Mitigation Measures Embedded in Credit Policy
Valuation	Valuation method	- Regular revaluation - Based on current market value • With willing buyer and seller • At arm's length • Reasonable period for sale • Freely exposed to market - Based on reasonable and prudent assumptions - Valued at realizable market value • Net of carry cost • Net of repossessed collateral • Net of legal fee • Net of other associated charges for disposal
	High volatility	- Apply conservative haircut - Quantum of haircut depends on volatility - A sudden rebound in price is ignored - Top-up
	On bad debt	- More prudent valuation
	Valuer's competency	External - Establish criteria to accept external value - Keep a list of external valuers and surveyors - Back-test the valuation with actual sales proceeds versus estimated value Inhouse - Cross check inhouse valuation with external valuers - Independent from marketing or credit initiation
	Severe conditions	• Stress testing (depends on the outcomes, may have further mitigation measure)

1.3.3 Identify the relevant credit risk indicators

1.3.3.1 Assess the situation for developing execution plan

(1) Assessment of the situation to identify the most suitable approach in risk management and execution

Banks should have flexible information systems and analytical techniques that provide sufficient information on the risk profile and structure of the credit portfolio for

- continuous evaluation of the existing forecasting and review approach
- evaluating the effectiveness of different approaches to risk management for risk mitigation or transfer

(2) Examples of the indicators of the account risk profile

- Product/Type of facility
- Terms – repayment
- Terms – interest rates
- Terms – others
- Size of exposure – Secured
- Size of exposure – non-secured
- Size of exposure - groups of related borrowers
- Size of exposure – Sectors (geographic, industry)
- Account performance – delinquency
- Internal credit rating – current
- Internal credit rating – future over the life of the individual loans in the portfolio
- Outstanding versus commitments
- Types ad coverage of collateral

(3) Examples of portfolio indicators computed with conventional methods and statistical tools

Banks could compile risk indicators at the portfolio level with simple exposure aggregation. Banks could also compile risk indicators by applying statistical tools on the exposure at default[38]. RPs who would like to understand the basics of application in credit portfolio analysis may catch up with the research reports from BIS.org.

With the deployment of statistical tools for portfolio analysis, several benefits exist.

- Simulation of different approaches in risk management with direct risk limits becomes possible to develop the most suitable strategy.
- Simulation of different approaches of risk mitigation measures becomes possible for developing the most suitable mitigation strategy.

The table below shows some examples of portfolio risk indicators:

Forms of Concentration Risk	Methods to Compute Indicators of Concentration in Particular Counterparties
Large Exposure	Individual count
	Groups of linked counterparties
Sector Exposure	Specific economic sectors
	Specific industry sectors
Sovereign Exposure	Specific geographical locations
Collateral Exposure	Collateral assets in land or shares
Correlation	Sector correlation leading to contagion effect
	Default correlation leading to contagion effect
Others	Foreign currencies
	Maturity funding

The table below shows an example of Portfolio Risk Indicators with application of statistical methods:

No. of Loans	10	50	100	500	1,000	2,000	3,000
VaR (95%)	0.0526	0.0508	0.0459	0.0393	0.0386	0.0378	0.0389
VaR (99%)	0.5264	0.1695	0.1009	0.0786	0.0773	0.0763	0.0758
VaR (99.9%)	0.5263	0.1864	0.1284	0.0982	0.0971	0.0950	0.0947

Credit VaR at the specified level of confidence expressed as a fraction of total portfolio exposure. The calculations assume PD=1% and asset correlation of 20%. The economic capital (credit VaR) varies over a sequence of loan portfolios.

[38] Page9, Studies on credit risk concentration: an overview of the issues and a synopsis of the results from the Research Task Force project - November 2006 (bis.org)

1.3.4 Identify the relationship of risk level change with loan provision

1.3.4.1 Evaluate effectiveness of mitigation

<u>The trainer's and guest specialists' sharing in seminar during the class:</u> **Trainers will update the latest development on loan classifications, providing rules and regulations, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.**

<u>(1) Impact of account risk changes to provisioning</u>

May refer to the Section 1.1.4

<u>(2) Impact of portfolio risk changes to provisioning</u>

RPs should be familiar with the implication of portfolio level credit risk indicators to the senior management and try to obtain insight from the indicators by asking strategic questions. The table below shows some examples of credit risk indicators:

Credit Risk Indicators	Default Risk	Exposure Amount	Recovery Rate	Liquidity	Boundary	Concentration
Aggregate exposure versus portfolio limit - By industry - By country - By product - By type of counterparty • Banks • Non-bank financial institutions • Corporates • Retail customers, etc.		✓			✓	✓
Total portfolio by internal credit rating and trend		✓			✓	✓
Total exposure to groups of related countries		✓			✓	✓
Large exposures		✓				✓
Connected lending		✓				✓
LTV asset-based lending with loan-to-value ratios exceeding pre-set limits (e.g., mortgages with			✓			

loan-to-value ratios exceeding 70%)						
Ageing Overdue accounts with ageing analysis (i.e., amounts overdue one, three, six months etc.)	✓					
Risk migration Credit downgrades and loans rescheduled during the period	✓					
Interest payment Interest suspended	✓					
Adequacy of provisions	✓					
Facilities expiry	✓					
Undrawn commitment Ratio i.e., undrawn facility amounts as a percentage of total facilities				✓		
Loan-to-deposit ratio				✓		
Results of stress testing - Policy or limit amendments - Hedging - Exposure reduction (e.g., through asset sales, securitization, etc.) - Contingency planning for actions to be taken should a particular scenario happen	✓					✓

1.3.5 Identify key regulations, report remedy and make recommendation

1.3.5.1 Provide suggestions on improvement

(1) Reporting prudential limits

If a bank, in the opinion of the HKMA, is exposed to a significant level of risk concentration that may affect its financial stability, the HKMA may set prudent limits on the bank's exposures case-by-case basis to particular

- Counterparties
- Economic sectors
- Geographical sectors

(2) Clustering limits

If a bank has many sizable single exposures, it needs to set an internal limit on its large exposures and risk concentration policy to control the aggregate of its non-exempt large exposures, which should be

- Realistic
- Should not be so high that it could never be breached

The HKMA will consider whether

- The level of the bank's capital adequacy ratio
- Consistency with the bank's large exposures and risk concentrations policy
- The number of exposures
- The individual size and nature of business of borrowers concerned
- The characteristics of the bank, including the nature of its business and the experience of its management

(3) Current risk management review

With the deployment of statistical tools in credit risk management, quantitative analysis can be conducted to construct various scenarios. Though this will give RPs relatively visible outcomes in the comparison of different simulated risk mitigation measures, RPs should bear in mind that the assumptions should be validated carefully from two perspectives: the historical data generated from within the bank and the forecasted data generated with economic outlook, industry outlook and the inherent risk of companies within the target markets.

1.4 Submodule 4: Stress Testing

<u>Note to trainers</u>
Trainers can pick, change, and repackage the content sample below according to learners' needs

1.4.1 Introduction

A banking crisis is hard to predict. A global database of banking crises was first compiled by Caprio and Klingebiel (1996). The latest version of the database, updated to reflect the recent global financial crisis, is available as Laeven and Valencia (2012). It identifies 147 systemic banking crises (of which 13 are borderline events) from 1970 to 2011. It also reports on 218 currency crises (defined as a nominal depreciation of the currency vis-à-vis the U.S. dollar of at least 30 percent, which is also at least ten percentage points higher than the rate of depreciation in the year before) and 66 sovereign debt crises (defined by government defaulting on its debt to private creditors) over the same period. The database has detailed policy responses to resolve crises in different countries. Analyses based on the dataset, such as Cihák and Schaeck (2010), suggest that consistently predicting banking crises is very difficult, but there are some variables (such as those capturing high leverage and rapid credit growth) that indicate an increased likelihood of a crisis.

Although the crisis is hard to predict, portfolio management enables proactive credit risk management before serious problems arise. What's more, stress testing has become relevant to advert banks' management regarding the credit portfolio performance during stressful conditions.

1.4.2 Monitoring of portfolio – theory and practice

1.4.2.1 Suitable approach to stress testing

Banks conduct portfolio analysis with assumptions of "normal" conditions and "stressful" scenarios from time to time.

(1) Enterprise collaboration

Various credit risk management functional units perform the portfolio analysis continuously or regularly to ensure timely identification of early warning signals and subsequent remedial actions. The table below summarizes the fundamental portfolio analysis:

At Portfolio Level	Proposed Frequency	Performed By
Performing portfolio analysis and risk assessment by type, sector, and internal credit rating	Monthly	Middle office
Performing trend and ratio analysis	Monthly	Middle office
Conducting loan migration analysis or stress test	Monthly	Middle office
Reviewing portfolio risk concentration	Monthly to Quarterly	Middle office/senior Management/credit committee/Board of Director
Monitoring compliance with internal and regulatory limits	Daily	Middle Office/compliance unit
Monitoring connected lending	Monthly to Quarterly	Credit committee/Board of Director

While there is a proposed frequency in the SPM, the frequency of monitoring with portfolio analysis should be increased if there are identified weaknesses or the facilities are approaching the limit.

(2) Normal conditions

Credit risk characteristics of a portfolio determine how external factors (e.g., macroeconomic factors, industry factors) and internal factors (e.g., entities financial strength, business strength) impact its risk level.

Understanding the portfolio's characteristics and sensitivity to the changes in external and internal risk factors is therefore essential for a bank's planning and control of credit risk with CRM techniques.

(3) Stressful conditions

While a bank might not have a crystal ball on hand, it relentlessly collects early warning signals, implements risk mitigation measures, sets standards to control the portfolio risk, effect risk transfers, and ensure adequate underwriting criteria for new loans booked.

However, with technological advancement leading to globalization, interlinkage between different credit risk portfolios increases and becomes more complex.

Stressful conditions in one geography might have a contagious effect on another, similar to economic sectors and counterparties. Therefore, portfolio analysis is beneficial to credit risk management under these circumstances.

(4) Planning for stress testing

Analysis from a portfolio perspective enables the credit risk management to understand the key drivers which impact the portfolio level risk upon changes in the external risk factors. As a result, the management obtains insights into credit risk management planning and control. The analytical framework on the next page shows examples of asking the right questions for stress testing scenarios:

Strategic Questions to Ask about Credit Risk Management	Under Normal Conditions	Stressful Scenarios		Type of Analysis
		Under Assumed Stressful Conditions	Contingency Plan Adequacy	
What is the risk profile of the credit portfolio?	X	X	X	- Exposure at risk - Probability of Default - Recovery rate - Tenor
How much more risk the bank could take?	X	X	X	
How has the new product launch changed the portfolio risk?	X	X	X	
How much loan provision is adequate?	X	X	X	
How adequate is the liquidity to meet the risk commitment?	X	X	X	
Is risk return commensurate with the risk appetite?	X	X	X	- Risk-return
How adequate is the bank's capital to absorb the risk?	X	X	X	- Credit Loss Distribution - Tail risk
What is significant risk of the credit portfolio?	X	X	X	Concentration by - Country - Geography/ Location - Sector - Industry - Product - Counter-parties - Tenor - Maturity - Collateral - Guarantee
Which are the vulnerable sectors in the portfolios?	X	X	X	
How effective has the portfolio diversification strategy been?	X	X	X	
What should be the prioritization of diversification?	X	X	X	
What should be the prioritization of risk transfer in case of early warning signals?	X	X	X	
What is the concentration risk to the bank's advantages?	X	X	X	
How effective was the portfolio diversification when default rate suddenly surges with change in the economic conditions?	-	X	X	Correlation of - Country - Geography/ Location - Location - Sector - Industry - Product - Counter-parties - Tenor - Maturity - Collateral - Guarantee
What are the interlinks in the credit portfolio?	X	X	X	
What will be the contagion effect when a particular industry face significant downturn?	-	X	X	

(5) Limitations of stress testing

The Board and senior management should be made aware of the limitations of the stress test performed. Examples are:

- Extent of judgement by risk controllers, economists, business managers and traders and the quality of internal dialogue and debate among the relevant experts
- Key underlying assumptions on the design and setting of stress scenarios taking into account of spectrum and severity of events
- Likelihood of a stress event occurring

1.4.2.2 Evaluate the existing portfolio

(1) Stress testing

Banks are expected to have in place stress-testing programme appropriate to the nature and complexity of their business activities. Stress-testing involves the use of various techniques to assess a bank's potential vulnerability to adverse changes in market conditions.

(2) Purpose

RPs should continually evaluate existing portfolios to ensure early identification of credit quality deteriorating signals, desirable outcomes achieved with implemented mitigation measures, timely remedial actions taken, and, most importantly, the credit risk levels within risk appetites.

(3) Functions

Stress testing is proactive credit risk management serving the following functions:

- Enhance forward-looking assessment of risk exposure under stress conditions
- Enable the development of appropriate risk mitigation strategies
- Enable the development of contingency plans under stressed conditions
- Enhance understanding of the risk profile
- Facilitate monitoring of changes in the above risk profile
- Enable the Board and senior management to review the setting of the risk appetite (e.g., To evaluate whether the statement "The bank is to withstand a mild recession while achieving break-even profitability and maintaining an X% Tier N capital reserve" holds under stressful scenario)
- Enable the management to review whether risk exposures commensurate with the risk appetite
- Enable the management to incorporate assumptions on "volatility and correlation" in stress-testing scenarios
- Enable RPs to quantify "tail risk" (risk of losses under extreme conditions) using statistical risk measures (value at risk, economic capital model)
- Identify vulnerability sectors with bank-wide impact
- Enable the management to evaluate the bank's capacity to withstand stressed situations (profitability, liquidity, capital adequacy)

(4) Outcomes

RP needs to review reports of the stress testing outcomes to prepare for remedial actions for senior management's endorsement:

- Policy or limits amendments
- Hedging
- Exposure reduction by risk transfer (e.g., asset sales, securitization)
- Contingency planning for actions to be taken should a particular scenario happen (e.g., To evaluate whether the statement “The bank is to withstand a mild recession while achieving break-even profitability and maintaining an X% Tier N capital reserve” holds under a stressful scenario)
- Enable the management to review whether risk exposures commensurate with the risk appetite
- Enable management to incorporate assumptions on “volatility and correlation” in stress-testing scenarios
- Enable RPs to quantify “tail risk” (risk of losses under extreme conditions) using statistical risk measures (value at risk, economic capital model)
- Identify vulnerability sectors with bank-wide impact.
- Enable the management to evaluate the bank’s capacity to withstand stressed situations (profitability, liquidity, capital adequacy)

(5) Stress testing design

Different scale and complexity

The table below shows examples of the HKMA suggested adaptation regarding stress testing:

Overall Direction	Banks with Small and Simple Operations	Bank with Large and Complex Operations
The HKMA adopts a “proportionate approach” when assessing banks' stress-testing programme, having regard to the nature, scale, and complexity of - their business activities - risk associated with those activities	Banks with small and simple operations with less risk in the activities will **not** have an elaborated and sophisticated stress-testing programme.	Large and complex banks should be able to undertake more extensive and sophisticated stress testing.

Stress events, risk models and potential challenges

Banks frequently conduct stress testing have cumulated more experience to overcome the potential challenges of stress testing. The table below mentions some of these potential challenges:

Category	Potential Challenge	Possible Solutions
Management oversight	Provide inadequate Board and senior management oversight of the stress-testing process	The Board and senior management understand thoroughly the stress test scenarios and approve the stress testing.
Stress event	Under-estimate the potential severity and duration of stress events	Take from lessons learned from the past
Stress event	Take into Inadequate account of system-wide interactions and feedback effects caused by the market reactions to stress conditions	
Non-systematic risk factors	Have insufficient identification and aggregation of risks on a firm-wide basis	Improve continually on internal rating quality
Risk models	Have limitations associated with stress-testing models and methodologies (e.g., inability to change stress scenarios flexibly in response to a rapidly evolving environment, and breakdown of statistic relationships in time of stress.)	Improve continually
Products complexity	Have an inadequate coverage of risks arising from, for example, - Complex structured products - Pipeline/securitization risk - Counterparty credit risk	The Board and senior management understand thoroughly the stress test scenarios and approve the stress testing
Funding liquidity	Manage risk within the markets which are highly interactive and monetary and fiscal policies of big markets have significant impacts on market liquidity	Seek for expert inputs to the stress-testing scenario assumptions

1.4.2.3 Key factors for stress testing

<u>(1) Stress testing design</u>

The analytical framework below summarises the key risk factors to be considered in the stress test:

Factors related to Credit Risk Management	Nature	Measures
Credit risk	Non-systematic	**Default probabilities** - Rise in delinquencies - Rise in charge-offs - Decline in recovery rates - Value of supporting collateral - Rating migration of counterparties - Rating change of Issuers or credit protection providers - Worsening of credit spreads - Internal risk rating
Concentration	Non-systematic	**Concentration** - Individual counterparties - Products/instruments - Industries - Market sectors - Countries or regions
Contagion effects	Non-systematic	**Inter-relationships** - Over time - In time of Stress - Across markets - Across countries - Across regions - Across counterparty types - Across asset class
Macroeconomic conditions	Systematic	**Default probabilities** - Economic downturns - Significant market shocks - GPD growth - Change in property prices - Unemployment rate - Inflation rate/ deflation rate
Interest rate	Systematic	**Yield curve** - Parallel shift - Twist - Basis risk (Increase in basis risk - changes in relationships between key market rates)

Market/price risk	Non-systematic	**Changes in price/fair market values** - Currencies - Equities - Commodity - Other financial instruments/derivative positions
Product specific e.g., complex products	Non-systematic	**Prepayment amount and frequency** Contingent credit (e.g., derivatives) exposure
System-wide interaction and feedback effects	Non-systematic	**Likely behavioural responses of other market** Participants and their counterparties on the broader market in times of stress, and how that impact would feedback to the bank's positions.
Modelling assumptions - Correlation - Volatility - Holding period	Non-systematic	**Value-at-risk model/pricing model**
Political and economic factors - Industries - Regions - Markets	Non-systematic	**Value-at-risk model/pricing model**

At a boarder level, other relevant risk factors might include

- Liquidity risk
- Operational risk
- Strategic risk
- Reputation risk

1.4.2.4 Quantify sensitivity of the portfolio with design methodology

(1) Testing plan and altering assumptions

Stress Testing Programme Outline	**Content (Banks Remains Flexible to Respond Fast)**	**Remarks**
Main objectives	- Identify risk - Control risk - Improve capital and liquidity planning	Articulate to risk appetite
Governance structure	- Board of Directors (Responsible) - Senior Management (Accountable) - Business Managers - Risk Managers - Traders	Aware of limitation, Actively engaged
Frequency	- Dependent on type and purpose of stress-testing - Fixed interval	
Methodology	- Each component in the stress-testing programme - Method to define relevant scenarios - Method using role of expert judgement	
Assumptions and fundamental elements	- Range of key scenarios - Severity of key scenarios	
Procedures	- Reporting of outcomes - Review of outcomes - Recommended remedial actions - Feasibility of remedial actions under stress conditions	Robust MIS
Review	- Independent review - Update of stress testing programme • Market circumstances • Bank's developments	
Changes	- Approval by the Board, or - A committee delegate of the Board	
Documentation requirements	- Stress-testing exercises outcomes - How test-results are used - Management decision to take mitigation action - Outcomes of evaluation of stress-testing assumptions	

(2) Testing scenarios from lessons learned

Banks should adopt typical scenarios such as downturns in an industry or the overall economy, liquidity squeezes, and adverse market developments or interest rate trends.

There are multiple dimensions to come out with stress testing scenarios. The analytical framework below shows some examples of the lessons learned:

	Past	Trend	Black Swan
Lessons learned	2008: USA – Sub-prime 1997: Asian – Financial Crisis 1986: Russia – Chernobyl	2022: Europe – Russia war with Ukraine 2005: Climate Change – Katrina	Unknown area
Economic risk scenario	RPs could source sample information from Subprime mortgage crisis: 10 years later, market revival Asia's long road to recovery after the Asian financial crisis. Economic scene after Chernobyl's incident.	RPs could source sample information from Ukraine Conflict in May 2022 which knock $1 trillion off global GDP US's Katrina's Unique economic Impact	
Industry risk scenario			
More examples on lessons learned	1987: Market crash 1998: Russian Crisis 2001: Terrorist attack in the US 2003: SARS outbreak 2008-09: European Sovereign Debt Crisis		

1.4.2.5 Alter assumptions in different variables

<u>(1) Stress testing programme</u>

<u>Stress test programme – scenario example (A) domestic economic downturn</u>
Stress Testing estimates the impact on a bank's asset quality, profitability, and capital adequacy of adverse changes in selected macroeconomic variables (e.g., GDP growth, unemployment rate, interest rates, bankruptcy rates, asset price, etc.) that are relevant to the bank's exposures.
The economic downturn in significant economies affects the local area.

Stress Testing also estimates the impact on a bank's counterparty exposures (e.g., corporate loans, holdings in securities, interbank exposures, etc.) as a result of the economic downturn in major economies with significant financial/commercial/trading links with Hong Kong.

For example, an RP could measure the impact in terms of a drop in corporate borrowers' business revenues or an increase in default risk of their trading counterparties).

<u>Stress test programme – scenario example (B) decline in the real estate market</u>
This estimates the impact of a decline in property prices on

- Collateral coverage
- Default risk
- Provisioning needs for loans secured by properties

<u>Stress test programme – scenario example (C) decline in the value and market liquidity of financial collateral</u>
This estimates the impact of a decline in the valuation and market liquidity of financial collateral held by banks, which reduces the quality and quantity of the collateral, leading to lower collateral coverage and recovery rates and higher provisioning needs and capital charges.

<u>Stress test programme – scenario example (D) increase in classified loans and provisioning levels</u>
This assesses the resilience of a bank's loan portfolios in terms of the impact of such increases on its profitability and capital adequacy. In designing the scenario, a bank may apply different percentages of increase in classified loans and provisioning levels to its loan portfolios.

Or a bank may conduct a loan migration test by assuming that certain percentages of the loans in each of the first four categories of the HKMA's five-grade loan classification system is downgraded to the next category.

Stress test programme – scenario example (E) rating migration of counterparties

This is performed based on the internal or external credit ratings of a bank's credit exposures, by migrating a certain percentage of the credit exposures of a specific rating grade (by one or more notches) to a lower rating grade (or to a higher rating grade in respect of short credit risk positions taken) and assessing the resultant impact on the bank's profitability and capital adequacy.

Stress test programme – scenario example (F) default of major counterparties

This estimates the impact of default of a bank's major counterparties, including

- Corporate
- Sovereign
- Bank counterparties

On its profitability as well as liquidity and capital adequacy.

Extension of the test covers aggregate exposures to

- Major industries
- Market sectors
- Countries
- Regions

i.e., significant number of defaults occur within such aggregate exposures

Stress testing programme – scenario example (G) decline in the value of taxi licences/ gross operating income of taxi drivers

- This estimates the impact on an AI's taxi loan portfolio in terms of collateral coverage
- Default risk
- Provisioning needs

(2) Hypothetical scenarios

Banks should review lessons from history and tailor the event (develop the hypothetical scenarios) to reflect the risks to which they are most exposed:

- External Environment
- Market Environment

Contagion effects on related markets

Lessons learned from the above event:

- Relationship between different risk factors
- The extent to which the above relationship change would exacerbate a crisis

(3) Quality assurance

Quality of a stress test depends on multiple factors. The table below summarises the key considerations for evaluation:

Category	Considerations
Bank characteristics	- Activities complexity and risk level - Capital and earning capacity to absorb shock - Risk management policies
Bank management	- Level of oversight
Stress test programme	- Scenarios - Parameters - Assumptions - Procedures
Outcomes	- Risk exposures relative to the bank's stated objectives and risk tolerance
Capacity	- The capacity of the bank's capital and earnings to absorb potential losses under stressed situation
Contingent plan	- Adequate actions to take when a particular stress scenario happen
Review and Audit	- Adequate internal revie on stress test programme - Adequate audit

(4) Compliance

After 2007 global financial crisis, regulatory bodies and banks drive for more stress testing. A quality stress test must comply with a certain structure that provides an audit trail. The table below gives an example of adequate documentation for stress-testing:

Documentation	Adequate Document for Stress-Testing Procedures
Credit Risk Management	Integrate stress-testing into daily risk management
Approval Process	Adequate party for the approval process
	All changes to the stress-testing methodology and procedures be approved by senior management.
Scope	Scope of exposures be included in the programme
MIS	High integrity of MIS
Position Data	Accurate and complete
Data Quality	Consistent, timely, reliable data sources used to run stress test
Validation	Validation of the stress-testing results through back-testing historical scenarios (e.g., the 1997 Asian crisis) and their impact on the bank portfolios.

1.4.3 Identify vulnerable sectors in the portfolios

1.4.3.1 Analyse situations with scenarios to identify vulnerable sectors

(1) Analyse accounts and portfolios

Note to trainers
Trainers may obtain the sample reports from banks to tailor cases for assessment with short questions. Trainers may obtain sample financial statements and cash flow schedules from banks to tailor cases for assessment with long questions.

Stress-testing is conducted more frequently today, with internal demand from banks and regulatory demand from the authorities. Banks also carried out stress testing at account levels.

- For both adaptions suggested above, RPs should ask the questions including but not limited to the existing credit profile of the portfolios/the significant accounts
- Design hypothetical scenarios for stress testing of the portfolio/the significant account
- Analyse the outcomes of stress testing on the following
  - Vulnerable portfolios
  - Change in risk rating
- Recommend mitigation for portfolio/remedial action for the significant accounts

(2) Insight from stress testing

Stress-Testing is conducted more frequently today, with internal demand from banks and regulatory requests from the authorities. The follow-up of the Stress Testing should emphasize:

- Whether the risk level of the loan portfolio under stressed conditions is within banks' appetite
- Whether the contingent plan is still resilient under stressed conditions to ensure that the estimated risk is adequate and that the planned actions are implementable
- Whether the credit guidelines are still resilient under stressed conditions to ensure systematic intake of quality loans
- Whether the communications on the implementation of the credit guidelines are to be enforced with more communication sessions with different functional units

1.4.4 Identify key regulations, report remedy and make recommendations

1.4.4.1 Consolidate results to develop suitable measures

The trainer's and guest specialists' sharing in seminar during the class: **Trainers will update the latest development on key regulations updates, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.**

(1) IFRS9 – provisioning implication on planning

Banks have traditionally generated economic scenarios for financial planning and stress testing purposes. With IFRS9 provisioning, economic scenario forecasting will directly impact accounting. The use of data sources, models, and expert judgment when forecasting scenarios can create undesired biases in financial records. Banks will have to identify, assess and mitigate potential biases of IFRS9 provisions

(2) Mitigation of potential biases of IFRS9 provisioning

IFRS9 is based on the management approach, which focuses on information about the components of the business. However, because of the size of the potential impacts, there are risks of material bias affecting the financial statements. Therefore, mitigation strategies should be in place to reduce the risk of material bias. The table below shows some examples of mitigation strategies:

Bias Type		Bias Description	Mitigation Strategies
1	Variable selection bias	Use of limited set of macro variables	- Comprehensive set of variables across portfolios - Consistent methodology to extend variables - Analysis of interconnections across variable
2	Anchoring bias	Scenario design over-relies on certain values, trends, or data source	- Multiple sources of variables - Through the cycle source data - Workshops with business experts/senior executive
3	Model bias	Use of models based on inaccurate relationships/narrow model driver selection	- Model risk management governance and controls - Model validation, back-testing, and benchmarking
4	Probability bias	Over or under confidence in scenario severity Over or under estimation of probability selection (optimism or conservatism bias)	- Coherence of probability across planning exercises - Probability measurement challenge and assurance - Probability adjustment using business judgement
5	Opinion bias	Influenced by limited set of views or behaviours in group discussions/traditional group behaviours	- Objective workshop facilitation - Formalized governance and process including CFO/CRO approval
6	Results bias	Bias towards specific level of provisions Bias due to influence of senior executives Bias on results outcome early in the process	- Pro-forma impact assessment tools - Prioritization of qualitative and quantitative conclusions - Peer benchmarking

Source: IFRS9 Planning and Stressing Testing, ALVAREZ & MARSAL (Microsoft Word – IFRS9_Amthoughts_v15.docx (clubgestionriesgos.org))

1.4.4.2 Develop contingency plan

(1) Following up on the portfolio risk mitigation

Stress testing should facilitate the development of risk mitigation or contingency plans across a range of stressed conditions. The performance of risk mitigating techniques, like hedging, netting, and the use of collateral, should be challenged and assessed systematically under stressed conditions when markets may not be fully functioning. Multiple institutions simultaneously could be pursuing similar risk mitigating strategies[39]. Learners are best to read the bis.org articles on stress testing to be familiar with the principles of stress testing.

[39] Principles for sound stress testing practices and supervision, May 2009 (bis.org)

1.5 Submodule 5: Account Monitoring and Problem Loans

Note to trainers

Trainers can pick, change, and repackage the content sample below according to learners' needs

1.5.1 Introduction

RPs should understand the process of credit monitoring and evaluate the performance of clients' accounts to compare with credit strategies and portfolio objectives of banks to identify critical areas for further follow-up actions. RPs should be able to evaluate information related to current and projected financial status of applicants, hence, to re-assess the bank/client relationship and carry-on necessary actions promptly.

1.5.2 Monitoring portfolio – theory and practice

1.5.2.1 Knowledge in borrowing account monitoring

<u>(1) Objective of account monitoring</u>

Account monitoring is a credit management process that refers to the day-to-day monitoring of the performance of individual credits and the overall portfolio. In addition, the process helps to identify early warning signals of delinquency resulting from insufficient cash or a lack of willingness to service the debt.

Account monitoring is for ensuring

- Credit servicing in compliance with facility terms, e.g., covenants and collaterals
- Identification of early signals of delinquency
- Timely reporting of irregularities/default/breach/remedial actions and effectiveness
- Credit limits are complied with
- Regulatory limits are complied with
- Provisions are realistic
- Credit Committee/senior management monitors the portfolio quality

<u>(2) Responsibility of account monitoring</u>

Levels	Monitor	Frequency	For Credit Risk Management
The Board / credit committee	Portfolio	Periodic	Set - Large exposure risk parameters - Connected exposure risk parameters
Front office	Accounts	Day-to-day	Recommend - Changes in internal credit rating - Changes in provision
Middle office	Quality	Periodic	Apply - Stress Test - Other Techniques
	Limits	Day-to-day	Report - Exceptions
	Problem account	Day-to-day	Check - Proper grading - Provision
Back office	SOP	Day-to-day	Support - Process Fulfillment
Back office	SOP	Day-to-day	Report - risk exposure

(3) Functional units to perform account monitoring

It's about teamwork. Every party in the credit risk management structure is responsible for the credit quality by performing their different roles and responsibilities. The same collaboration applies to ongoing account monitoring. Therefore, RPs should possess a basic knowledge about the segregation of duties and how appropriate data and information move around in companies to enable timely follow-up actions on the accounts.

Monitoring at Account Level	Monitor at Portfolio Level
Credit monitoring performed by the marketing or account officers in the front office.	Middle or back office involved in the process with more high-level monitoring

(4) Following up problem loan

There are different possibilities to align credit risk management principles with some of the best practices for the problem loan review process. The table below shows an analytical framework to consider relevant options regarding the problem loan review process:

Questions to be Asked	Option 1	Option 2	Option 3
Who follows up?	Account officer	Problem loan unit	Problem loan unit
What's the case nature?	Less serious	More serious	More serious
What's the objective?	Nurse the account	Explore restructuring Explore additional finance	Collateral recovery Enforce guarantees Enforce collection
Who contacts borrower?	Account Officer	Problem loan unit, or Account Officer	Problem loan unit
What's the desirable outcome	Restore account	Nurse the borrower's financial position	Collateral recovery Enforce guarantees Enforce collection

Account quality monitoring

A quality credit monitoring should include documented

- System
- Procedures
- Processes
- Standards

To monitor regularly

- Performance
- Quality e.g., borrowers' capacity to repay
- Conditions

1.5.2.2 Keeping up to date industry performance

(1) Account quality monitoring

Each credit review at the account level it's a combination of three pillars of quality. The table below shows some examples of elements under the three key pillars:

Frequency	Qualitative Factors	Quantitative Factors
- Regular interval under normal circumstances - On demand upon significant market event	- Review fulfillment of T&C - Study the business dynamics - Study the industry dynamics	- Review changes in the indicators - Compare with peer companies to identify irregularities

1.5.2.3 Reviewing, analysing, comparing for tracking irregularities to identify risk level and root causes

(1) Document review

Document review is an essential process to ensure borrowers' compliance with the loan terms and conditions:

Absolute compliance

Document review is critical. There have been cases where delayed fulfilments of financial statements, per the covenants, for one day at the month-end turn the accounts to "special mention" status (refer to the section on loan provisioning), affecting both banks' interest and borrowers' interest in loan renewal or new loan application. Therefore, RPs should sensitize themselves to the importance and rationale regarding the document review and update process.

Throughout loan term – document update

The quality of an account is ascertained before disbursement and monitored throughout the loan life. Hence monitoring of documentation updates is necessary throughout the loan life. The table below shows some examples of the required documentation update to confirm the quality of borrowers' accounts:

Documents	Description	On-Going Monitoring
Background on the borrower	- Name and address	Upon change, need to identify the causes and sources of change e.g., business model change e.g., owner change
	- Organization, history, principal activities	Upon change, need to identify the causes and sources of change for e.g., revenue e.g., assets

	- Certificate of incorporation - Memorandum and articles of association - Borrowers' authority to borrow - Third party references	Upon change, RPs need to identify the quorum, the approval authority, and the causes and sources of change
	- Experience of expertise in the trade	Upon change of management team, need to update on the core competency change
	- Past three years' financial performance (including audited accounts and information on facilities obtained from other banks if applicable)	Monitor on timely submission, which may be early warning signals
Purpose of the credit and facilities requested	- Terms of repayment and interest	Need to monitor the drawdowns fits the purpose of the loan. T&C meeting the acceptance criteria of the underwriting.
	- Conditions: • Details of collateral, its current valuation and evidence that the collateral's existence has been verified • A copy of the certificate for the insurance of the collateral.	The changes in values of collaterals and quality of the guarantees could be an early warning signals to the repayment capability of borrowers.
	- Conditions: Nature and details of any guarantees together with an assessment of the net worth of the guarantor	
Assessment of credit application	- Borrowers' financial position at time of drawing, prospects, projected cash flows, capital resources, and other commitments	Identify in the financial position, financial strength and understand the causes and sources of change.
	- Details of other exposure to borrowers or other related borrowers (cross-referenced to the central liability record)	Identify early warning signals through industry network on the changes in the repayment capability.
	- Details of verification of information provided by borrowers, e.g., reference taken, valuation required	
	- Result of stress-test	Give relevance information about the what if scenarios
	- Internal credit rating accorded	Update regularly or on demand upon market situation changes.
Approval	- Name(s), rank(s), and signature(s) of approving officer(s) - Facilities approved	

	- Expected rate of return, preferable on a risk-adjusted basis, on the facility - Copy of credit documentation (agreement, facility letter, guarantee, pledge of securities, etc. The original should be kept in a fire-proof sale.)	
Updating records	- Movement of funds or periodic balance of facilities - Movement or periodic balance of collateral - Current financial information on borrowers - Meeting notes	Updated financial analysis based on the latest information provided.
Assessment of internal credit rating and provisions	- Details of assessment and justifications - Movement of internal credit rating - Movement of provision made - Current interest accrual status	Regular update and identify causes and sources of any changes.
Review	- Incidental intelligence concerning borrowers - Copies of exception reports arising from regular monitoring - Copies of the reports produced for the periodic review	Regular update and identify causes and sources of any changes.

Throughout loan term - document review to identify risk factors for risk mitigation/remedy

Monitoring of Borrowing Account	Stage	Risk Factors and Risk Mitigation
Approval on credit application	Approval	Credit and Operations compliance
Facility limits in system	Initiation	Credit compliance
Loan agreement	Initiation	Customer's T&C compliance
Guarantees	Initiation	Legal risk
Transfers of title to collateral	Initiation	Legal risk
Legal document safe custody	Initiation	Operation risk
Customers' authority to borrow	Initiation	Legal risk
Valuation of collateral	Initiation	Market risk
Liens on deposit	Initiation	Credit risk
Custody of key documents - The disbursement of funds - The entering of limit into database	Initiation	Operations
Draw-down approval	Approval	Operations compliance
Funding of loan with Treasury	Initiation	Liquidity risk
Interest rate fixing with Treasury	Initiation	Interest rate risk
Customer's compliance with T&C record	Post-credit	Customer's terms and condition compliance
Customer repayment records	Post-credit	Default risk
Customer's current financial information	Post-credit	Changes in risk characteristics
Whole credit file complete and up to date	Post-credit	Customer's T&C compliance
Management information on the credit portfolio	Post-credit	Aggregation to obtain portfolio risk profile
Independent audit on credit administration department	Post-credit	Credit and Operations compliance

(2) Consolidate information to analyse changes

Unless it is a one-off operational issue causing the delay in payment, there are early warning signals if the delay comes from the deterioration of the repayment capability. Therefore, the fundamental decline of repayment capability should have been reflected in the internal rating during the regular account monitoring. Internal rating is an excellent process to consolidate all relevant updated information from the company. What's more, the internal rating will be referred to for other credit risk management decisions.

1.5.2.4 Identifying early signs of delinquency for problem loan management and prompt remedial actions

(1) Early delinquency signals

During the ongoing account monitoring process, the credit risk management team reviews the changes in risk factors in the entity, the industry, and the macroeconomic environment. In addition, the financial analysis of updated financial statements will also provide early warning signals on potential delinquency.

(2) Causes of delay in payment

A loan turns into a "problem" when the payment is delayed. First, however, credit risk management needs to consider if the cause of the delay is fundamental or technical. The actual reason is more related to the change of the entity's inherent risk or the economy's systematic risk. The technical cause is more associated with the internal operational risk of borrowers.

1.5.2.5 Theories and knowledge of lending

(1) Comprehensive external factor reviews to arrive at recommended account actions

The table below shows some examples of due diligence on account reviews and monitoring:

<table>
<tr><td rowspan="1">Due diligence

e.g.,
document review
e.g.,
on site visit</td><td colspan="3">- A bank has a system to ensure periodic credit reviews of individual accounts or accounts managed or a portfolio basis are carried out independently by the middle office.
- Generally, all facilities should be individually reviewed at least yearly. However, more frequent reviews would be necessary when facilities are irregular, larger, or riskier.
- Regarding the parties conducting the review and approval process, it depends on the various credit risk management structure for different banks according to their natures.</td></tr>
<tr><td rowspan="2">Update and outlook

e.g.,
economy
e.g.,
industry
e.g.,
borrowers</td><td>Entity Review</td><td>Industry Review</td><td>Macro-Economics</td></tr>
<tr><td>- Know Your Customers
- Borrowers’ business model
• Five Force Model
• SWOT
• Canvas business model
- Borrowers’ accounting policies
• Alignment with financial figures booked/reviewed
• Missing information on the financial statements
- Early warning signals (submodule 1), including signals from
• Collaterals
• Guarantees
- How borrowers and guarantors are doing in other banks
- Account analysis
• Stress test
• Sensitivity analysis</td><td>- At what stage is the industry cycle now
- The historic performance of borrowers in the past at similar stage
- Whether the growth plan matches with the industry cycle and whether agreed milestones are met</td><td>- Changes in GDP growth, CIP, Unemployment, and others</td></tr>
<tr><td>Analyse client credit risk</td><td colspan="3"><table><tr><td>Changes in credit indicators and adequacy</td><td rowspan="5">- Identify sources and causes of changes in risk level
- Identify changes in customers/counterparties needs
- Confirm adequate credit risk strategy and policy
- Formulation of revisions in response to changes/trends
- Trigger remedial actions to protect banks in case of credit quality deterioration</td></tr><tr><td>Changes in loan classification and adequacy</td></tr><tr><td>Changes in provision and adequacy</td></tr><tr><td>Changes in opportunities and threats</td></tr><tr><td>Changes in the quality of the portfolio</td></tr></table></td></tr>
<tr><td>Outlook</td><td colspan="3">Participating Industry, Client’s business outlook, predicted activities, financial and business forecast</td></tr>
</table>

(2) Management attention

Credit risk management should manage problem loans with a lot of management attention to ensure

- Timely remedial actions taken
- Timely risk mitigation measures implemented
- Timely lessons learned be embedded in the credit manual, process, procedures

Senior management is engaged in the review of the problem loans. A regular monthly reporting to the Credit Committee or Senior Management put in place to

- Oversee debt recovery process
- The work of the problem credit management
- Information on the problem credits

(3) Problem loan impact

- Depress profitability because there are provisions, write-offs, or carrying cost
- Make an impact on banks' liquidity due to the reduction in cash receipt
- Time consuming for different levels in the credit risk management

(4) Principles of problem loan management and examples of some best practices.

Most of the problem loans are unique in their combined nature. Therefore, checking and balancing the relationship with borrowers is delicate. Nevertheless, there are principles and suggested practices to follow to enable RPs to exercise unbiased judgment with problem loans. The tables below show some examples:

Principle	Best Practices	Remarks
Independence	Credit officers with expertise in corporate workouts and business restructuring are responsible for following up on problem loans.	Applies to the more severe case, the following officers are **not** considered independent - Market/Account Officer/Relationship manager likely to be too close to the borrowers - The credit officer who approved the problem credit

Principle	Best Practices	Remarks
Swift	Reduce exposure promptly in the interest of banks	Where the case can be justified, it is usually preferable for a borrower in difficulty to be helped towards recovery rather than put immediately into liquidity or bankruptcy.
	Reclassification of the loan, if applicable	Loan classification affects both loan provisioning which has specific guideline and the available risk capital.

Principle	Best Practices	Remarks
Secure the security	Consult with professional (e.g., legal advisor) with experience in the matter	The legal title needs to be perfect for security to be effective.

1.5.3 Identify delinquent payment’s root causes

1.5.3.1 Identifying critical area and changes for follow up

<u>(1) Information generated from credit indicators</u>

Ongoing account monitoring with credit indicators generates valuable information relevant for credit risk management actions. The table below shows some examples of the changes in the credit indicators that trigger pertinent actions of credit risk management:

<table>
<tr><td>Changes in credit indicators and adequacy</td><td rowspan="5">- Identify changes in customers/counterparties needs
- Confirm the credit risk strategy, policy is adequate
- Formulation of revisions in response to changes/trends
- Trigger remedial actions to protect the bank in case of credit quality deterioration</td></tr>
<tr><td>Changes in loan classification and adequacy</td></tr>
<tr><td>Changes in provision and adequacy</td></tr>
<tr><td>Changes in opportunities and threats</td></tr>
<tr><td>Changes in the quality of the portfolio</td></tr>
</table>

Stress testing applied at the account level can reveal account performance under stressful scenarios; the account performance could be indicated by, for instance, the return on risked weighted assets expressed in the following concept:

Revenue / (Probability of default X Loss of Default)

<u>(2) Principle of portfolio credit risk management and monitoring</u>

Banks’ credit risk monitoring approach depends on its nature, size, and complexity. Therefore, banks should develop policies, methodologies, and procedures for measuring credit risk. The approach adopted should cover on-balance and off-balance sheet products, aligned with the nature, size, and complexity of a bank’s activities.

(3) Portfolio level credit indicators

The table below lists out some examples of the focus areas for on-going monitoring at portfolio level:

Dependencies of Ongoing Portfolio Performance	Examples Of the Dependencies	Indicators to Monitor
Type of facilities	- On-balance sheet clean loan	- Counterparty Risk
	- Off-balance sheet	- Current Exposure - Potential Future Exposure - Pre-settlement Risk - Settlement Risk
Repayment schedule	- Fixed Pre-payment	- Credit risk in notional amount
Outstanding against limit	- Uncertain utilization	- Statistical estimation of utilization rate & corresponding default rate
Portfolio maturity profile	- Long duration with distant maturity date	- Net present values varied embedding interest rate
Security	- Collateralized Loan	- Difference between notional default value and collateral value
	- Product with master netting agreement	- Netted amount
Credit quality	- Changes in internal credit rating over the life of individual loans in the portfolio	- Internal credit ratings and expected default rates aligned to the rating to produce risk-adjusted return
	- The same counterparty groups	- Aggregated limit
	- The same industry	- Aggregated limit
	- The same country	- Aggregated limit

1.5.3.2 Evaluating current and projected financial status

(1) The migration of individual credits through the various grades with an automatic/judgmental credit rating system

Automatic versus judgmental credit risk rating
Banks are encouraged to adopt a system that can map with but is more sophisticated than the 5-grade loan classification system currently employed for regulatory reporting.

There are practical purposes to enable banks to perform credit risk management with more insights on:

- Credits that are not yet irregular

The judgmental rating will facilitate the early identification of deteriorating credits and remedial actions to minimize credit losses. The table below shows comparison of rating systems:

Automatic-Rating System	Judgmental Rating System
Based on - a pre-determined set of objective rating criteria e.g., past account performance.	Based on - underlying creditworthiness of borrowers - financial strength of the guarantor(s) - financial strength of the collateral pledged - risk of specific transactions

Potential outcomes of loan account monitoring
The outcomes of individual account monitoring are to arrive at the recommendation of the subsequent credit actions, such as:

- Loan renewal
- Loan amount increase
- Loan extension
- Curtail loan amount
- Cancel loan
- Restructure loan

1.5.4 Identify the relationship of risk level changes with loan provision

<u>The trainer's and guest specialists' sharing in seminar during the class:</u>
Trainers will update the latest development on loan classifications, providing rules and regulations, the relevant credit cases, lessons learned, and experience sharing. Alternatively, the trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.

1.5.4.1 Monitoring accounts for advising alternative services

As the credit quality of a loan account deteriorates, the cost of bearing the credit risk increases, with credit provisioning as one of the costs. RPs might help borrowers to identify a more appropriate alternative service where risk is commensurate with returns.

<u>(1) Loan provisioning purpose</u>

A loan classification system enables banks to prudently value loans and to act as a guide to the appropriate provisions.

<u>(2) Motivation for improvement</u>

Banks spend much effort to improve the loan classification for both regulatory requirements and optimization of loan provisions to have greater consistency and accuracy in bank reporting.

(3) Loan provisioning

General and specific

The analytical framework below helps RPs to sensitize with the credit pricing and follow up with borrowers on timely fulfillment of the T&C of the loan:

	Specific Provisioning	General Provisioning
About the provision	Condition Where losses are certain and likely Provision The percentage to be provided will depend on the particular circumstances	Condition Over and above specific provision Provision Based on the historical loss experience Based also on the assessment of future economic trends in the market in which they operate
Room for credit risk management judgment	**Judgement on credit history and future economic trend** Here the management exercise judgement based on the past and the vision on the future about the accounts/portfolio yet to become "problem."	
RPs' sensitivity to the credit pricing	**Individual accounts** Credit risk RPs should be sensitized with the credit history of borrowers at time of credit price setting, as there is a cost on the general loan provisioning.	
	Loan portfolio RPs should sensitize themselves to timely follow-up of milestones agreed upon loan inception. A systematic non-disciplinary follow-up approach might lead to systematic deterioration of the portfolio credit history and increase the loan's cost with general loan provisioning.	

By loan and portfolio basis

Provisions On Loan-By-Loan Basis	Provision On Portfolio Basis
Condition If provision could be assessed on a loan-by-loan basis **Provision** Full provision being made for the likely loss **Expert opinion** The level of provisions is normally a matter for a bank to determine in consultation with its external auditors. **HKMA intervention** The HKMA reservices the discretion to intervene where in its opinion the bank is being - Insufficiently prudent in its approach or - Seriously out of line with the provisioning policy of its peers	**Condition** If it is not possible to estimate the loss reliably **Provision** Sub-standard: 20 – 25% of unsecured portion Doubtful: 50% - 75% of unsecured portion Loss: 100% of unsecured portion

Per loan classification

Loan classification is an essential indicator of collectability for an account whose interest and principal payments are overdue. The table below shows examples of classifications of loans with payments past due:

Delinquency/ Payment in Arrears Indicator	Other Deficiencies/Early Warning Signals on Unsecured or Partially Secured Loans	Loan Classification	Conditions for Exceptions I.E., Allowed for Better Classification
NIL		**Pass** - Loans are current in meeting commitment and full payment of interest. Principal is not in doubt	
Less than 3 months	- Credit history or performance record is not satisfactory - Significant deficiencies are present which threaten borrowers' business, cash flow and payment capability - Labor disputes or unresolved management problems which may affect the business, production, or profitability of borrowers' business - Borrowers experiencing difficulties in repaying obligations to other creditors - Construction delays or other unplanned adverse events resulting in cost overruns that may require loan restricting	**Substandard** - Loans where borrowers are displaying a definable weakness that is likely to jeopardize repayment. - Loans where some loss of principal or interest is possible after taking account of the "net realizable value" of security - Rescheduled loans where concessions have been made to customers on interest or principal such as to render the loan "non-commercial" to the bank	
More than 3 months		**Substandard**	If there are good reasons for a better classification e.g., the loan is fully secured by good quality collateral
Less than 6 months	- Default, - Death, - Bankruptcy, - Liquidation of borrowers - Unknown whereabout of borrowers	**Doubtful**	
More than 6 months	- The net realizable value of security is insufficient to	**Doubtful**	

	cover the payment of principal and accrued interest;	- Loans where collection in full is improbable and the institution expects to sustain a loss of principal and/or interest after taking account of the net realizable value of security	
More than 12 months	- Even where principal and accrued interest are fully secured but delinquency more than 12 months	**Substandard** - Loans where borrowers are displaying a definable weakness that is likely to jeopardize repayment. - Loans where some loss of principal or interest is possible after taking account of the "net realizable value" of security - Rescheduled loans where concessions have been made to customers on interest or principal such as to render the loan "non-commercial" to the bank	
Experiencing difficulties	- Borrowers are experiencing difficulties which may threaten the bank's position; and - Ultimate loss is not expected at this stage but could occur if adverse condition persists - Where the loans exhibit one or more of the following characteristics: • Early signs of liquidity problems such as delay in servicing loans • Inadequate loan information such as annual audited financial statements not	**Special Mention**	

	obtained or available • The condition of and control over collateral is questionable • Failure to obtain proper documentation or non-cooperation by borrowers or difficulty in keeping contact with him • Slowdown in business or adverse trend in borrowers' operations that signals a potential weakness in the financial strength of borrowers, but which has not reached a point where servicing of the loan is jeopardized • Volatility in economic or market conditions which may in the future affect the borrower negatively • Poor performance in the industry in which borrowers operates • Borrowers or in the case of corporate borrowers, a key executive is in ill-health		
Default		**Loss** - Loans which are considered uncollectible after	

		exhausting all collection efforts such as realization of collateral, institution of legal proceedings, etc.	

1.5.4.2 Determining provision amount

<u>Quality of loan provisioning and credit operations accuracy</u>

The quality of loan provisioning depends on the credit operations' accuracy in classifying loans according to their delinquency status. There is a strong linkage between credit operations risk and credit risk management quality.

When identifying the operational risk, RPs should consider both internal and external factors that could adversely affect the achievement of banks' objectives, such as

- the Bank's management structure, risk culture, human resource management practices, organizational changes, and employee turnover
- the nature of the Bank's customers, products, and activities, including sources of business, distribution mechanisms, and the complexity and volumes of transactions
- the design, implementation, and operation of the processes and systems used in the operational cycle of the Bank's products and activities
- the external operating environment, the industry trends, the political, legal, technological, and economic factors
- The competitive environment and the market structure

1.5.5 Identify key regulations, report remedy and make recommendation

<u>The trainer's and guest specialists' sharing in seminar during the class:</u> **Trainers will update the latest development on key regulations updates, the relevant credit cases, lessons learned, and experience sharing. Alternatively, trainers may arrange for veteran RPs as guest specialists to share these topics in the suggested one-hour seminar during the class, or, for in-house training, combine the sharing in the regular credit conferences of the banks. The seminar can take place as the last session of the class.**

1.5.5.1 Debt restructuring

<u>(1) Credit risk management process in compliance with operational risk management</u>

Operational Risk Management should ensure that the Credit Risk Management Process deploys the tools commonly used for identifying and assessing related operational risks:

- Self or risk assessment – a bank assesses its operations and activities against a menu of potential risk vulnerabilities. This process identifies the strength and weaknesses and controls gaps in the operational risk environment by incorporating checklists and workshops.
- Risk Mapping – In this mapping process, a bank identifies its credit risk management organizational functions or process flows by risk types. This process identifies the strength and weaknesses of the operational environment. This exercise can reveal areas of weakness and help prioritize the risk after mapping.
- Risk Indicators – These indicators provide insight into a bank's risk position. They alert a bank about the changes that may indicate risk concerns.
  e.g., the number of failed trades
  e.g., staff turnover rate.
  e.g., frequency of errors
  e.g., frequency of omissions
  e.g., the severity of errors and omissions

<u>(2) IFRS 9 management application in pricing and product design</u>

According to the research by Alvarez & Marsal, the management application of IFRS9 mainly focused on two areas. The table below gives a summary of the key drivers of the provisioning:

IFRS9-Provisioning Affected by Credit Driver: Maturity	**IFRS9-Provisioning Affected by Credit Driver: Riskiness**
Lifetime calculation of expected losses will specially affect long-term-maturity portoflios such as commercial mortgage	Riskier portfolios such as unsecured loans will contain higher portion of stage 2 and thus higher provision levels.

The table below gives a brief summary of the implications:

Implication (1)	Implication (2)
IFRS9 provision levels and impacts will substantially vary among banks per portfolio composition and business model structure.	As provisions increases due to IFRS9 implementation, adjustments on certain products or clients should be analysed to ensure the cost of credit is correctly captured, and profitability (ROE) remains above expected thresholds Adjustments to new organization to be analysed include - Change in pricing models - To either increase price, or - To shorten the maturity - Early redemption incentive A more material adjustment A partial or full swift in portfolio mix by running-off loan categories that are high risk and covered by other less regulated competitors

1.5.5.2 Classifying unpaid debt customers for making claims

Judgment on loan classification

The decision to classify loans should be primarily judgmental based on assessing borrowers' capacity to repay and the degree of doubt about the collectability of the principal or interest of a loan.

2 Module 2 - Content Notes

2.1 Submodule 1: Financial Analysis

<u>Note to trainers</u>
Trainers can pick, change, and repackage the content sample below according to learners' needs

2.1.1 Introduction

"Would you lend your money to this customer?"

A bank collects deposits and lends to the borrowers. As a depositor of the bank, you lend money to a borrower via the bank which acts as an intermediary. A bank has the responsibility for lending depositors' money to a borrower with high level of analytical commitment.

A bank should have Credit risk assessment based on, including but not limited to, thorough analysis on the business performance (ability to generate profits) and financial strength (ability to withstand adversity) as well as the loan applicant's willingness to timely repay.

2.1.2 Accounting concepts

Note to trainers

Accounting is a subject by itself leading to a professional degree. For learners who have worked in job positions for one year should be familiar with financial analysis. The Training Package should include a few points essential to facilitate RPs' investigation on the credit worthiness of the credit applicants. RPs need to accumulate experience reading all industries' financial statements because these company documents provide essential information about a particular borrower's business key drivers. RPs could compare similar key drivers in other companies in the same industry.

<table>
<tr><th>Concept</th><th>Brief Description</th></tr>
<tr><td>1.
Accounting is a science</td><td>Accounting is an information science that plays a vital role in collecting, organizing, recording, analyzing, and reporting a business because it tracks incomes and expenditure and ensures statutory compliance. It also provides management, investors, government, and other stakeholders (e.g., a lender) with historical figures on financial information for decision-making in the future.</td></tr>
<tr><td>2.
Dual transaction basics</td><td>A company must register each financial transaction in pairs, and this nature of accounting enables the identification of irregularities in a company. For instance, one of the fastest-growing coffee chain start-ups has extraordinary steep growth in sales revenue, and that sales growth has not resulted in a similar increase in cash balance. This company was subsequently delisted from the stock exchange.</td></tr>
<tr><td>3.
Values of financial statements</td><td>In compliance with accounting standards, a company registers every financial transaction onto the financial statements: income statement, balance sheet and cash flow statement. Therefore, the financial statements give many hints to satisfy the investigative requirements of credit risk assessment.</td></tr>
<tr><td>4.
Financial statements tailored for stakeholders</td><td>
<table>
<tr><th>"Books" targeted for different stakeholders</th><th>Adaptation for the Specified Stakeholders</th><th>Types of Statement</th></tr>
<tr><td>Financial Statements for Lenders and shareholders</td><td>The listed companies usually provide only published financial statements to their lenders. Therefore, even when RPs identify early warning signals from some sources about the listed companies, they would not be able to obtain any non-published interim financial statement update.</td><td>Balance sheet
Income statement
Cash flow statement</td></tr>
<tr><td>Management Book for the Board</td><td>Other than the published financial statements, companies maintain several books compiled from the same raw data but with different insights for external stakeholders and internal stakeholders. For example, book-keeping records,</td><td>Balance sheet
Income statement
Cash flow statement
Pro-forma statements</td></tr>
</table>
</td></tr>
</table>

<table>
<tr><td></td><td>
<table>
<tr><td></td><td>financial statements, management books, tax books.</td><td></td></tr>
<tr><td>Tax Book for Tax Authority</td><td>Companies in general applies accrual base of accounting. Accrued income does not mean payment is made by the customers. Accrued expense does not mean payment is made to the suppliers. When financial statements are provided for tax reporting purposes, there are special rules that apply.</td><td>Income statement in compliance with tax computation rules</td></tr>
</table>
</td></tr>
<tr><td>5.
Quality of financial statements</td><td>Financial statements must fulfill a common set of accounting standards if they are to be audited. Therefore, audited financial statements are comparable. This means that, audited financial statements have higher creditability than non-audited financial statements for credit risk assessments.</td></tr>
<tr><td>6.
Financial accounting standards</td><td>Depending on the origin of the companies, they consolidate financial statements according to different accounting standards. Examples are GAAP, relatively more rule-based, and IFRS, more principles-based. Usually, a company adopts standards consistently year on year. Therefore, the RPs sensitize to switching account standards from one to another and must be satisfied with the causes and sources of the change.</td></tr>
<tr><td>7.
Accounting standards for listed companies in Hong Kong[40]</td><td>According to the Hong Kong exchange listing rules, the financial history of results and the statement of financial position included in the accountants' report must conform with
• Hong Kong Financial Reporting Standards (HKFRS); or
• International Financial Reporting Standards (IFRS); or
• China Accounting Standards for Business Enterprises (CASBE) in the case of a PRC issuer that has adopted the CASBE for the preparation of its annual financial statements
Any significant departure from such accounting standards must be disclosed to the extent practicable, the quantified financial effects must be explained.

The relevant standards will generally be those current about the last financial year reported on and, wherever possible, with appropriate adjustments to show profits for all periods by such standards.</td></tr>
</table>

[40] Chapter 4, Listing Rule, Hong Kong Stock Exchange, untitled (hkex.com.hk)

<table>
<tr>
<td>8.
Accounting policy</td>
<td>
Significant changes in the income statement and balance sheet items are usually explained by the accounting policy changes. Reading accounting policies could be one of the most effective methods to dig out missing pieces of information.

Important accounting policies are:
<table>
<tr><th>Income</th><th>Expenditure</th><th>Assets</th><th>Liabilities</th><th>Currency</th></tr>
<tr>
<td>Recognition of profits on long-term contracts</td>
<td>Cost incurred for research and development

Historical cost/ Current Cost Accounting</td>
<td>Depreciation and inventory policies (e.g., LIFO, FIFO, COGS)

Valuation of investments

Treatment of goodwill</td>
<td>Treatment of leases

Treatment of contingent liabilities</td>
<td>Translation of foreign currency items</td>
</tr>
</table>
In-depth understanding about the borrowers' accounting policies to boost profit or reduce losses or to show a better financial position is important in financial analysis. The accounting analysis includes understanding on critical accounting activities (e.g., inventory management), accounting choices (e.g., inventory cost registration), accounting estimates (e.g., inventory count, amortization years of intangible assets), judgement (e.g., whether an aged trade receivables would eventually be collected).
</td>
</tr>
<tr>
<td>9.
Information to look for in financial statement</td>
<td>
<table>
<tr><th>Financial Statement</th><th>Key Components</th><th>What to Look For?</th></tr>
<tr><td>Income statement</td><td>Revenue</td><td>Consistency of revenue, with or without growth</td></tr>
<tr><td>Income statement</td><td>Direct cost</td><td>Cost control capability</td></tr>
<tr><td>Income Statement</td><td>Selling and marketing expenses</td><td>Cost efficiency to generate revenue</td></tr>
<tr><td>Income Statement</td><td>Rental expense</td><td>Risk of lease renewal/early termination</td></tr>
<tr><td>Income Statement</td><td>Trade receivable write-off</td><td>Risk of non-payment by customers</td></tr>
<tr><td>Income Statement</td><td>Amortization</td><td>Under valuation of intangible assets over-states, the borrower's net profits</td></tr>
<tr><td>Income Statement</td><td>Interest payment</td><td>How the interest payment affects the shareholder's sharing of the company's profit</td></tr>
</table>
</td>
</tr>
</table>

10. Relation between income statement and balance sheet	Data and information extracted from the balance sheet, income statement, and cash flow statement, whether from a publicly listed company or a private company, are valuable information for cross-referencing the validity of one another. - For instance, sales revenue on the income statement links closely with the accounts receivable on the balance sheet. When sales revenue increases, accounts receivable are likely to increase. However, whether the reported receivable balances are growing faster than the sales revenue and whether the accounts receivable ageing differs from the previous years all provide hints to the quality of the income. From the cross-reference of related information and data above, RPs would be able to suggest that the company has missed out on information for the financial strength assessment. - For instance, the Cost of goods sold links closely with the inventory value on the balance sheet. Therefore, the value of the stock might be one of the key drivers leading to changes in the Cost of goods sold. On the other hand, suppose the Cost of goods sold goes down while the inventory value keeps building up. In that case, which might suggest overvaluation of the inventory, change of inventory policy, policy to stock up list or its liquidity. From the cross-reference of related information and data above, RPs would be able to suggest that the company provides additional/missing information for financial strength assessment.

		Related to Income Statement Items							
	Balance Sheet Items	Sales revenue	Cost of goods sold	Depreciation expense	Amortization expense	Operating expense	Interest income	Income tax expense	Net income
	ASSETS								
1	Cash	X							
2	Accounts receivable	X							
3	Inventory		X						
4	Prepaid expenses					X			
5	Fixed assets			X					
6	Accumulated depreciation			X					
7	Intangible assets				X				
	LIABILITIES AND EQUITIES								
8	Accounts payable		X			X			
9	Accrued expense payable					X		X	
10	Accounts payable						X		
11	Shareholders equity – capital								
12	Shareholders equity – Retained earning								X

		Related to Balance Sheet Items											
	Income Statement	Cash	Accounts receivable	Inventory	Prepaid expense	Fixed assets	Accumulated depreciation	Intangible assets	Accounts payable	Accrued expense payable	Accounts payable	Capital	Equity
	Income												
a	Sales revenue	X	X										
	Expense												
b	Cost of goods sold			X					X				
c	Depreciation expense					X	X						
d	Amortization expense							X					
e	Operating expenses				X				X	X			
f	Interest income										X		
g	Income tax expense									X			
h	Net income												X

11. Investigative approach of credit risk management: financial statement analysis and examples of questionable transactions

The critical questions in ascertaining the financial statements quality are: Are there over-statement, understatement, missing statement, or mis-interpretative statement? The analytical framework below enables the determination of best methodologies for analysis of financial position and financial strength:

	Publicly Listed	**Privately Owned**
With track record	Financial Analysis	Transaction Analysis
Without track record e.g. , Start up	IPO Business Model	Collateral analysis Guarantor analysis

-Basic Awareness of potential financial statement gimmicks

Making financial statements comparable is essential for meaningful financial analysis. Understanding the limitations on the quality of financial statements, RP is to ascertain a company's financial performance over time against peers in the same industry. The list below indicates the four critical financial statement analyses:

- Income statement analysis
- Balance sheet analysis
- Cash flow statement analysis
- Rate of return analysis

	-Basic steps to identify prime areas for further investigation:
	• Vertical study: to compare the dollar amount of an item to a specific anchor item; examples are:
	  o Income statement analysis: cost of goods sold as a percentage of the total revenue in the income statement
	  o Balance sheet analysis: current liabilities as a percentage of existing assets
	• Horizontal analysis: compare the year-on-year dollar amount of an item; examples are:
	  o Income statement analysis: changes in the cost of goods sold as a percentage of total revenue over time
	  o Balance sheet analysis: changes of current liabilities as a percentage of existing assets over time
	• Cash flow statement analysis: changes in cash from operations over time
	
	-Basic skills to reconstruct financial statements: spreading of financial data with a bank's standard spreadsheet
	With the help of the standard spreadsheet provided by a Bank, RPs would apply the financial data. During the process, the RPs will perform according to the bank's definition embedded in the spreadsheet, or there is a possible judgment regarding aggregation, segregation, and reclassification of financial data
	
	-Basic skills to reconstruct financial statements: qualitative analysis
	Other than quantitative analysis, a more qualitative analytical perspective needs to take place (e.g., an interview with key management to identify motivation and incentives) to verify whether the financial analysis has any omission and deformation which might mislead the outcomes of the financial statement analysis.
	
	Example of questionable capitalization of expenses
	AOL financial system in 1995 and 1996, the company capitalized, rather than expensing, the acquisition cost of the subscribers to delay the pre-tax loss recognition. In 1995, the pre-tax loss was reduced from USD98 million to only USD21 million. In 1996, the pre-tax loss was reduced from USD175 million to USD62 million in 1996[41].
	
	Example of questionable over- and under-estimation of reserve at discretion
	The S.E.C. investigated into the Microsoft's reserve practices[42] during the fiscal year 1994 to 1998. The company set higher reserves for returned software or bad debt accounts during well performing quarter and in the opposite manner during an underperforming quarter.
	
	Example of questionable cash flow from acquisitions
	From 1996 to 2002, Tyco International Ltd[43] acquired hundreds of companies. At least USD500 million of the company's inflated operating income came from the acquisition. Since these transactions are treated as insignificant, the company has been able to account for the acquisition in the financial cash flow while putting the income of the acquired company as additional operating income.

[41] The accounting fraud's[1] the best part of the AOL CD lore. For fiscal years 199... | Hacker News (ycombinator.com)
[42] Microsoft: Accounting Scandal Avoided? | (cuny.edu)
[43] SEC Complaint: Tyco International Ltd.

(1) Sample statements to compile key ratios

Note to trainers

Trainers may obtain disguised client's financial statements from the bank to be base-material for assessment with short questions, long questions, or case-based questions. The table below shows a sample of income statement and balance sheet:

F Co. Ltd.		2021 HK$'000
Revenue		
Sales of food and beverages		2,641,319
Property rental		5,150
less: Cost of sales		(2,318,873)
Gross profit		327,596
Other revenue:		
Interest income		4,437
Government subsidies		89,348
Electric and gas rebate		5,166
Profit on sale of redemption gifts		766
Write-back of other payables		1,702
Other expenses:		
Loss on disposal of other property, plant and equipment		(9,779)
Foreign exchange loss		2,038
Other net loss		6,243
Selling expenses		(34,511)
Administrative expenses		(115,526)
Impairment loss on:	- other property plant and equipment	(34,310)
	- right-of-use assets	(59,377)
Valuation losses on investment properties		(8,570)
Profit/(Loss) from operation		175,223
Interest expense on bank loan		
Interest expense on lease liabilities		(36,824)
Profit/(Loss) before taxation		138,399
Income tax		15,218
Profit/(Loss) after taxation		153,617
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translation of PRC subsidiaries		4,737
Total comprehensive income for the year		158,354
Profit/(Loss) attributable to:		
Equity shareholders of F Co. Ltd.		153,617
Total comprehensive income/(loss) attributable to:		
Equity shareholders of F Co. Ltd.		158,354

F Co. Ltd.	2021 **HK$'000**	2020 **HK$'000**	2019 **HK$'000**
<u>Non-current assets</u>			
Investment properties	29,830	38,400	44,150
Other property, plant and equipment	424,866	474,711	468,503
Interests in leasehold land held for use under leases	-	-	5,980
Right-of-use assets	1,110,609	1,433,611	-
Lease receivables	2,768	-	-
Goodwill	1,001	1,001	1,001
Rental deposits paid	72,737	76,732	68,517
Debt securities at amortised cost	-	15,821	19,825
Deferred tax assets	3,935	22	44
	1,645,746	2,040,298	608,020
<u>Current assets</u>			
Inventories	46,008	50,828	33,560
Trade receivables	6,064	4,261	10,500
Accounts receivables	22,111	19,367	11,353
Prepaid rental and utility deposits	50,770	50,085	47,042
Lease receivables	2,239	-	-
Prepayments	18,580	16,468	33,529
Debt securities at amortised cost	16,745	3,141	11,950
Current tax recoverable	17,633	13,423	-
Cash and cash equivalents	622,143	511,047	519,854
Total assets	2,448,039	2,708,918	1,275,808
<u>Equity and liabilities</u>			
<u>Capital and reserves</u>	2021	2020	2019
Share capital	129,533	129,533	128,650
Reserves	648,303	591,273	649,028
Total equity	777,836	720,806	777,678

Non-current liabilities			
Lease liabilities	785,222	981,512	-
Deferred tax liabilities	1,795	14,036	19,599
Rental deposits received	1,768	1,173	2,286
Provisions	69,516	75,739	56,718
	858,301	1,072,460	78,603
Current liabilities			
Trade payables	326,634	386,957	354,951
Contract liabilities	10,587	9,354	3,061
Accounts payables and deferred income	22,353	20,992	27,164
Rental deposit received	204	1,142	27
Bank loan	-	-	143
Lease liabilities	433,320	479,851	-
Current tax payable	20	-	10,494
Provisions	18,784	17,356	23,687
Total equity and liabilities	2,448,039	2,708,918	1,275,808

	2021	2020	2019
Liquidity Ratios			
1. Current ratio = Current assets/Current liabilities	0.99	0.73	1.59
2. Quick ratio = (Current assets – inventory)/Current liabilities	0.48	0.23	0.87
Profitability Ratios			
1. Gross profit margin = (Sales – COGS)/Sales *100%	12.38%	9.15%	12.93%
2. Operating profit margin = (Operating profit/Revenue) *100%	6.62%	3.63%	7.24%
3. Net profit margin = (Profit after tax/Revenue) *100%	5.80%	2.01%	6.06%
4. Asset turnover ratio = Sales/Total assets	1.08	1.12	2.33
Working Capital Ratios			
1. Inventory turnover ratio = COGS/Average inventory	47.89	65.24	69.84
2. Receivable turnover ratio = Sales/Average receivables	512.63	410.57	328.13
3. Payable turnover ratio = COGS/Average payables	6.50	7.42	6.86
4. Cash ratio = (Cash and Cash Equivalents)/Current liabilities	0.77	0.56	1.24
Solvency Ratios			
1. Return on Equity (ROE) = (Net income-foreign exchange gain/(loss))/Shareholders' equity	0.20	0.08	0.23
2. Return on Assets (ROA) = Net income/Total assets	0.06	0.02	0.14
Financial Leverage Ratios			
1. Debt ratio			

= Total debt/Total assets	0.68	0.73	0.39

2.1.3 Financial ratios and key business drivers

Note to trainers
Banks have developed standard templates to capture relevant financial data. For learners who have worked in job positions for one year should be familiar with financial analysis. The Training Package should include a few points essential to facilitate RPs assessment on the credit worthiness of credit applicants. Trainers may embed essential knowledge and skill test in the assessment with short questions and long questions, rather than going through the details in the class session. The class session would be better used with learners' sharing on financial analysis "traps".

Financial ratios are practical tools to identify financial irregularities and information gaps. It is a comprehensive and highly articulated process to compare information from different sources and along time horizon until one is satisfied with the confirmed sources and causes of significant inconsistency, irregularities, or trends of income and financial positions revealed from the financial ratios. However, the analysis must be done within the relevant economic and industry context to achieve high quality. RPs should feel comfortable asking credit applicants all kinds of clarifying questions to arrive at a reasonable degree of confidence about the financials reflecting on the financial positions and strength of borrowers.

(2) Steps to prepare for financial analysis

The table below shows examples of financial analysis:

Steps in Financial Analysis	Description
Preparation for financial analysis	- A loan officer would do some prelim questioning • To assess the application validity before conducting an in-depth analysis • To analyse the strategic direction • To assess the major initiatives • To identify future potential challenges and opportunities for borrowers - For loans involving more than one bank, individual banks will conduct their in-depth financial analysis and credit judgment - For a project with the standard alone capability to repay debt obligations, the lender will conduct a quantitative analysis with the project profit and loss projection. - Otherwise, the lender will conduct a quantitative analysis of the conglomerate profit and loss of borrowers.
Identify industry cycle	Stage of Industry cycle
Refer to	Industry consultant engaged by the bank Veteran RPs specialized in the industry analysis

<table>
<tr><td>industry information</td><td>Industry report</td></tr>
<tr><td>Identify business cycle</td><td>Startup/Fast Growth/Cash Generation/Stagnation</td></tr>
<tr><td>Identify business model</td><td>5-C Model/the Five Force Model</td></tr>
<tr><td>Obtain basics about
Key business drivers</td><td>Business drivers are the key inputs and activities that drive the operational and financial results. Therefore, one should ensure that business drivers are solid and sustainable.

From industry report e.g., shipping industry, aviation industry

The analytical framework below lists out some examples of key business drivers that RPs can ask more questions about to generate valuable insights into the critical business drivers:

<table>
<tr><th>Key Business Drivers</th><th>Business Risk
Sales volumes
Sales price</th><th>Operations Risk
Material cot
Labor cost
Utilities cost</th></tr>
<tr><td>Reference</td><td colspan="2">- Existing borrowers in similar sector
- Major competitors in similar sector</td></tr>
<tr><td>Management choice</td><td>- Value Proposition</td><td>- Fixed Cost leverage</td></tr>
<tr><td>Technology platform</td><td></td><td>- Unit transaction cost
- Marginal transaction cost</td></tr>
<tr><td>Number of stores</td><td>- Sales/Store</td><td>- Number of inactive shops</td></tr>
<tr><td>Web site traffic</td><td>- Click through</td><td></td></tr>
<tr><td>Suppliers</td><td></td><td>- Terms of contract</td></tr>
<tr><td>Products</td><td>- Cross-sell ratio</td><td>- Unit production cost
- Marginal production cost</td></tr>
</table>
</td></tr>
<tr><td>List the external factors with impact on the business drivers</td><td>
<table>
<tr><th>Useful Information from Financial Statements</th><th>Revenue</th><th>Expenditure</th><th>Foreign Currency</th></tr>
</table>
</td></tr>
</table>

	Risk factors – macro-economics	**Economic risk** - GDP - Consumer expectations - Unemployment rate - Interest rate **Geography** - International firm - Local firm	**Market force** - Labor cost - Energy cost **Economic force** - Inflation rate	**Exchange Rate**
	Risk factors – industry risk	**Cycle stage** - Start up - Growth - Rapid Growth - Stagnation - Decline **Cyclical sector** - High - Airline - Retail - Moderate - Technology - Telecom - Low - Health care - Electricity network **Business cycle** - Seasonal - Sports - Travel	**Government acts** - Government regulations - Green policies - Electricity rationing	
	Risk factors – internal risk	**Product diversity** - Product range - Product innovation	**Operational scale** - Large scale lowers the cost - Small scale less price negotiation power	
	Relevant strategy model – the five forces	**Pricing power** **Hurdles to entrance** - Technology Patent - Capital intense **Customers** - Channel - Segment	**Supplier power** - Monopoly - Technology patent	
	Relevant strategy model – SWOT	**Competitive edge** - Market share - Technology distance	**Supply chain vulnerability** e.g., during COVID19	

<table>
<tr>
<td>Rank the significance of impact from the external factors.</td>
<td>The analytical framework below illustrates the estimation of the impact of the risk factors identified via the financial analysis process:
<table>
<tr><th></th><th>Risk Characteristics</th><th>Impact High</th><th>Impact Medium</th><th>Impact Low</th><th>Probability</th></tr>
<tr><td rowspan="16">Risk factors to be considered for a loan applicant:

- External factor
- Internal factor
- Cash flow for repayment matching with loan terms</td><td>Geography</td><td>H</td><td></td><td></td><td>Low</td></tr>
<tr><td>Denomination</td><td>H</td><td></td><td></td><td>Low</td></tr>
<tr><td>Currency</td><td>H</td><td></td><td></td><td>High</td></tr>
<tr><td>Economic</td><td>H</td><td></td><td></td><td>High</td></tr>
<tr><td>Sector</td><td>H</td><td></td><td></td><td>High</td></tr>
<tr><td>Industry</td><td></td><td>M</td><td></td><td>High</td></tr>
<tr><td>Business</td><td></td><td>M</td><td></td><td>Medium</td></tr>
<tr><td>Purpose</td><td></td><td>M</td><td></td><td>Medium</td></tr>
<tr><td>Loan Amount</td><td></td><td>M</td><td></td><td>High</td></tr>
<tr><td>Loan Tenor</td><td></td><td>M</td><td></td><td>Low</td></tr>
<tr><td>Company Type</td><td></td><td>M</td><td></td><td>Medium</td></tr>
<tr><td>Year in Business</td><td></td><td>M</td><td></td><td>Low</td></tr>
<tr><td>Collateral LTV</td><td>H</td><td></td><td></td><td>High</td></tr>
<tr><td>Product Type</td><td></td><td>M</td><td></td><td>Low</td></tr>
<tr><td>Financial Risk</td><td>H</td><td></td><td></td><td>Low</td></tr>
<tr><td>Financial Strength</td><td>H</td><td></td><td></td><td>Medium</td></tr>
</table>
</td>
</tr>
<tr>
<td>Reconfirm objectives of financial analysis</td>
<td>To assess the income generation capability of borrowers
To assess the financial strength of borrowers amid adverse economic condition
To understand the impact of external risk factors to the income stream
To confirm/validate borrowers’ financing needs/product needs which matches its repayment capability or specific requests (Note 1)
To identify further business opportunity with borrowers</td>
</tr>
<tr>
<td>Improve quality of financial ratio analysis by comparison</td>
<td>In-depth financial analysis could be obtained from comparisons of the financial ratios across entities within the same industries and against borrowers’ historic performance
<table>
<tr><th></th><th></th><th colspan="2">Means to Enhance In-Depth Understanding of the Business</th></tr>
<tr><td>Accounting analysis tool</td><td>Descriptions</td><td>Compare over time
- Economic cycle
- business cycle</td><td>Compare with industry
- Existing borrower
- Competitor</td></tr>
<tr><td>Common sizing analysis</td><td>This involves the technique of converting all items in the financial statements into a percentage of total so that</td><td>✓</td><td>✓</td></tr>
</table>
</td>
</tr>
</table>

		each number is expressed in relation to total assets or revenue. This is an efficient analytical tool as it facilitates a meaningful comparison between two variables which change during the same period of time (e.g., year-on-year balance sheet and income statement comparison).		
	Indexed trend analysis	This involves anchoring a certain year (examples are a year during or just after the global financial crisis) and convert the absolute numbers of each year into an index with the base year to facilitate better comparison and comprehension of the trend. This method has the advantages of showing business performance during the business cycles, demonstrate the financial outcomes of management decisions. It shows if the business is growing or shrinking relative to the significant base year.	✓	✓
	Ratio analysis	Ratio analysis is a principal tool of financial analysis. Through cross-referencing the items on the balance sheet and income statement, the hidden accounting changes or impact of policies are revealed. Key ratios for different stakeholders could be computed from the same balance sheet and income statement enabling each stakeholder to focus on the key areas.	✓	✓
Further improve quality of financial ratio analysis after	Site visit is an effective tool to verify the authenticity of documentation submitted and obtain additional information for assessment. (e.g., inventory conditions, collateral custody)			

site visit and others

Improve Quality of Information	**Verbatim**	**Quotations**	**Contract Transaction Proof Bank Statements**	**Site Shop Visit Web Site Traffic**
Sales	⊗	⊗	👍	👍
Bank Account Balance	⊗	⊗	👍	👍
Production Materials	⊗	⊗	👍	👍
Payment to Suppliers	⊗	⊗	👍	👍

⊗ doubtful quality 👍 better quality

…

Compile financial ratio

The tables below show the key financial ratios and their categorization:

Income	**Profit Ratio**
Income from core business is higher quality than extraordinary income	Return Type Ratio Margin Type Ratio Cost Efficiency Type Ratio

Return Ratio	**Margin Ratio**	**Cost Efficiency Ratio**
Return on assets	Net interest margin	Cost-income ratio
Net income/total assets	Net interest income/earning assets	Non-interest expense/ pre-provision income
Return on equity		Cost-assets ratio
Net income/ shareholders' equity		Non-interest expense/ total assets

Interpret financial ratio

Interpretation is as important as the computation of financial ratios. The analytical frame below illustrates purposeful interpretation of the financial ratio to trigger more relevant information to assess the credit risk of the borrower.

Topic	**Working Capital**	**Further Analysis and Follow Up on Missing Information/Additional Information**
Calculation	Relationship between current assets and current liabilities	- Changes over past years/seasons
Components	Current assets: - Accounts receivables - Inventory	For significant figures - Ageing on the accounts receivables

<table>
<tr><td></td><td>
<table>
<tr><td></td><td></td><td>- Inventory policy
- Major supplier contracts</td></tr>
<tr><td>Measure</td><td colspan="2">The business capability of a company to pay its short-term debt obligations with the current assets</td></tr>
<tr><td>Lower than industry average</td><td colspan="2">May indicate a risk of distress or default</td></tr>
<tr><td>Higher than industry average</td><td colspan="2">May indicate that the management is not using assets efficiently</td></tr>
<tr><td>Review on accounting policy</td><td colspan="2">Review the policy to classify inventory as current/obsolete</td></tr>
</table>
</td></tr>
<tr><td>Identify sources and causes of the outcomes of analysis</td><td>
<table>
<tr><th></th><th>Working capital ratio</th><th>Quick ratio/Acid-test ratio</th></tr>
<tr><td>Calculation</td><td>Relationship between current assets and current liabilities</td><td>Relationship between easily liquidated assets and current liabilities</td></tr>
<tr><td>Components</td><td>Current assets:
- Accounts receivables
- Inventory
- Other current assets e.g., prepaid, short-term investments
i.e., assets that could be turned into cash in less than one year

Accounts payable:
- Wages payable
- Tax payable
- Short-term trade payables
- Current position of long-term debt</td><td>Easily liquidated assets:
- Cash
- Accounts receivable
- Short-term investments

Accounts payable:
- Wages payable
- Tax payable
- Short-term trade payables
- Current position of long-term debt</td></tr>
<tr><td>Measure</td><td>The business capability of a company to pay its short-term debt obligations with the current assets</td><td>A more reserve approach to measure the business capability of a company to pay its short-term debt obligations with the quick assets</td></tr>
<tr><td>Lower than industry average</td><td colspan="2">May indicate a risk of distress or default (However, there is a limitation because the components could be very different from company to company)</td></tr>
</table>
</td></tr>
</table>

	Higher than industry average	May indicate that management is not using assets efficiently
	Review on accounting policy	Review the policy to classify inventory as current or obsolete Review the policy of payment terms to customers Review the policy on payment days to suppliers
	Risk	Very aged inventory still included as current assets.
	Example	Trainers may request RPs to compare the performance in fiscal year end 2021 of well-known brand names in same industries and discuss the causes and sources of differences.
Estimate business outlook	Form a judgment on the outlook	

<u>(3)Bank product types affects the selection of critical financial ratios</u>

Product	Product Brief
Project finance	One or two banks provide the finance based on the income of designated project. In case of project finance, the bank finances the project as an individual entity.
Syndication loan	Two or more banks combine to make huge syndication loans to borrowers. One lead financier may play a lead role in coordinating with other banks and making the funds available to the borrowers.
Corporate finance	Commits the finance based on the overall corporate income instead of relying on designated projects' income.
Trade finance	Finance the trading activities of borrowers
Commodity finance	Finance the commodities
Lease financing	This is off-balance sheet financing method. The arrangement provides control of the said asset without leveraging the balance sheet of the given borrower.
Borrowing-base facilities	A type of financing structure for producers of commodities, by which a company can pledge some of its assets to a lender. The value of this pool of assets, the "borrowing base" will constitute the amount of money loans.
Pre-export and prepayment finance	A PXF facility provides finance to producers of goods and commodities based on proven orders from buyers. In a classic PXF transaction, the borrower (and seller) uses funds to meet its working capital needs to cover the purchase of raw materials for production and costs in relation to storage and transport of goods.

Tolling finance	An agreement between two companies in which one agrees to supply a certain amount of a raw material ever so often. For instance, an oil refinery and a drilling company may agree that the drilling company will sell the refinery a certain number of barrels of crude oil every month so that the refinery has something to refine. Because of the tolling agreement, the refinery may be more confident that it can sell refined oil to other companies along the supply chain. Tolling agreements can therefore be mutually advantageous to the sustainability of the supply chain.

2.1.4 Limitation of financial statements

2.1.4.1 Identify information useful for account planning purposes

(1) Scenarios on initial overall impression of the financial statements

After the financial statements of analysis, there is a good idea about the financial strength and profit generation power of a borrower. The analytical framework below shows different scenarios of credit worthiness:

Examples of Scenarios	Balance Sheet	Income Statement	Credit Worthiness
Scenario 1	Highly Liquid assets	Large cash generation	High
Scenario 2	Highly Liquid assets	Low cash generation	Medium
Scenario 3	Illiquid assets	Low cash generation	Low

(2) Limitation of financial statements

The first impression from the initial financial analysis needed to be validated. However, despite advanced financial analysis skills and technology, the financial statement analysis has limitations. The table below shows examples of limitations:

Principles/Practices	Consequences	Prudent Actions
Accrual accounting For most enterprises, the accounting is done on accrual basis	**Uncertainty** Long outstanding accounts receivables still classified as current	**Ask for** Major customer list Receivable ageing list
Snapshot financial position Income, expenditure, assets, and liabilities are all captured as of a particular date	**Window dressing** The underlying dynamics remain unknown to lenders	**Ask for** Study bank statements
Asymmetry information Hidden information on bad business situation	**Missing information** Inventory stocked at the manufacturers rather than reflected in the financial statements	**Ask for** Major supplier list Summary of orders to major suppliers

Opaque information One party can observe the information and the other party cannot	**Credit quality change over time without being identified** Ageing customer portfolio without sufficient incoming new customers.	**Ask for** Customer portfolio analysis Product portfolio analysis

(3) Consequence of ignoring the limitations

Directors of companies are agents of a company. They should carry out their fiduciary duties in the best interest of the shareholders. With the limitation of the balance sheet, however, the directors might face temptation to breach the fiduciary duties. The analytical framework below shows examples to identify the upward and downward earnings management:

Upward Earnings Management	**Downward Earnings Management**
Upward manage the revenue to narrow down the earning differences across different periods Upward manage the revenue to distribute more bonus to the directors Influence the stock price which is one of the forms of compensation for the directors	Downward manage the revenue to narrow down the earning differences across different periods
Means to Upward Earnings Management	**Means to Downward Earnings Management**
Change from LIFO to FIFO to create a lower cost of goods sold, hence jetting up the earnings Change of project revenue recognition policy to create a higher income recognition Reevaluate the value of an asset (land) and have a gain captured as income	Change from FIFO to LIFO to create a higher cost of goods sold, hence suppressing the earnings Increase loan provision with a more prudent estimate Early cut off of sales order at year end to downward manage the revenue
Identification of Earnings Management[44]	
The company claims increase in revenue on the income statement but there is no corresponding increase in the cash accounts on the balance sheet.	
The company reports an increase in revenue when year-end is approaching, when year-end may not be a strong sales season.	
The company's account changes be put onto the radar screen for follow up.	

[44] Earnings Management, CFI, CFI earnings management - Google Search

2.1.5 Key business drivers

2.1.5.1 Define key business drivers

<table>
<tr><td>1.
Key business drivers</td><td>Business drivers are the key inputs and activities that drive the operational and financial results. Therefore, one should ensure that the business drivers are solid and sustainable.

<u>Example</u>
From industry report (e.g., shipping industry, aviation industry)

The analytical framework below shows examples of key business drivers with an impact on borrowers’ business and operations risk:

<table>
<tr><th>Key Business Drivers</th><th>Business Risk
Sales volumes
Sales price</th><th>Operations Risk
Material cot
Labor cost
Utilities cost</th></tr>
<tr><td>Reference</td><td colspan="2">- Existing borrowers in similar sector
- Major competitors in similar sector</td></tr>
<tr><td>Management Choice on</td><td>- Value Proposition</td><td>- Fixed Cost leverage</td></tr>
<tr><td>Technology Platform</td><td></td><td>- Unit transaction cost
- Marginal transaction cost</td></tr>
<tr><td>Number of Stores</td><td>- Sales/Store</td><td></td></tr>
<tr><td>Web Site traffic</td><td>- Click through</td><td></td></tr>
<tr><td>Suppliers</td><td></td><td>- Terms of contract</td></tr>
<tr><td>Products</td><td>- Cross-sell ratio</td><td>- Unit production cost
- Marginal production cost</td></tr>
</table>
</td></tr>
<tr><td>2.
Analyzing strategic direction</td><td>Sizable and structured company has mission and vision statement to communicate the strategic direction with shareholders, executive and teams.

The perfect implementation of the strategic direction requires a lot of management attention to carefully design the products and supporting marketing and operations strategies.

The outcomes of the implementation are aggregated transactions which are reflected on the financial statements.

Therefore, the outcome of financial analysis confirms whether the strategic direction is implemented accurately; or more importantly, the strategy direction aligns with the external environment changes over time.</td></tr>
<tr><td>3.</td><td>Both qualitative analysis and quantitative analysis must be done to evaluate the business model. Apart from the quantitative financial ratios, there are also qualitative means to express business models.</td></tr>
</table>

Expression of the business model	- 5Cs - SWOT - CANVAS
4. Evaluation of the business model	Comparison of borrower's business model against the industry norm and its major competitors is a straightforward means to evaluate the validity of the business model amid market competition. However, the comparison will more effectively generate insights for risk assessment if done with competitors of similar size. For comparing business of different scales, RPs might consider translating the financial statements to common base (e.g., all income statement items expressed as % of sales)
5. Assessing risk of potential financial loss on doing business with the borrower	RPs must solicit gather Information on the financial strength of the borrower - For listed companies, there may be press release and news reporting - For non-listed companies, site visits and faces interview with the management might help to form an impression on the management capability - Information from peers in other banks might be helpful but non-independent, which requires RPs to collect other information for validation (e.g., social media post by employees) RPs needs to consider both willingness and capability to service the debt
6. Identifying the key forces shaping the industry of the clients' business	The financial ratio analysis provides some insight regarding the major forces of the industry Examples - Negotiation power of borrowers in the supply chain could be indirectly proved by the cost control of the raw material for production - Pricing power of borrowers in the market could be indirectly proved by the price increase of the new product launch - Technology impact on borrower could be indirectly proved by its transactions done online versus in the physical shop
7. Analyzing value chain of the business to adopt a holistic consideration to assess risk and opportunities	The key considerations of the value chain include: - Supply chain - Talents in the company - Corporate culture e.g., innovation, productivity - Product branding - Customer loyalty (e.g., life-time value from repeated customer transactions)

2.2 Submodule 1: Financial Strength Assessment

Note to trainers
Trainers can pick, change, and repackage the content sample below according to learners' needs

2.2.1 Key business drivers

Credit Analysis is not rocket science. Instead, it is a comprehensive and highly articulated framework that asks for a systematic and thorough assessment of a borrower's willingness and capability to pay the obligations timely and in the manner demanded by the T&C stated in the loan covenants.

Because of the investigative approach to protecting the bank's interest, the characteristics of accounting, and the nature of financial statements, one must conduct a critical analysis and interpretation of all the essential data presented on the table.

2.2.2 Critical analysis of financial statements (internal factors)

2.2.2.1 Understand characteristics of different credit products offered by the bank

<table>
<tr><td>1. Knowing bank products</td><td>RPs should be familiar with the characteristics of different credit products. With the knowledge, RPs will sensitize to the missing information in the client's financial statements, or vice versa, whether there is any information in the financial statements which indicates that the client is likely to fit the credit criteria regarding its financial needs.</td></tr>
<tr><td>2. Examples of bank products</td><td>RPs should be comfortable conducting an initial introduction regarding the bank's product range, which elevates the client's willingness to collaborate with RPs in providing company information. The table below shows some examples for class discussions:
<table>
<tr><th colspan="2">Examples on Loan Type</th></tr>
<tr><td colspan="2"><u>Project Finance/Syndication Loan (Two and more banks sponsor syndication loan)</u>
Customers can raise funds through a project finance/syndicated loan to meet their huge capital needs. After agreeing with a bank as an arranger (a bank, for instance), customers can only approach the arranger to reach different banks via the network of the arranger. The arranger organizes information from various parties, including lawyers and participating banks, saving customers time handling loan documents, legal terms, pricing issues, completing the syndication, and meeting the financing needs for large real estate projects, business development, and mergers and acquisitions in a limited time frame.</td></tr>
<tr><th>Aircraft Financing</th><th>Ship Financing</th></tr>
<tr><td>Customers can raise funds through aircraft financing to enhance their competitive edge. For example, a bank that has established close relationships with airlines, aircraft leasing companies, insurance companies, valuers, and maintenance companies might provide aircraft financing solutions to airlines and leasing companies.</td><td>Shipping financing was once prevalent in Hong Kong. A bank with an extensive network worldwide, relevant experience, and a complete understanding of customer needs would offer credit offers to customers. The customers could ride the advantages of cross-border banking services and expand their business in different places. The offers include
- ship repayment financing
- ship financing
- bilateral loans
- asset-backed financing
- merger and acquisition loans
- structure finance
- financing with export insurance policy pledged
- others subject to the customer's needs and the bank's risk appetite

Banks may define a scope for applicable ships such as dry bulk carriers, oil tankers (crude tankers, product tankers, chemical tankers), general cargo and multi-purpose vessels, container ships, liquefied natural gas, and liquefied petroleum gas tankers, offshore support vessels, drilling platform, drilling vessels, oil storage vessels and floating production, storage tanks and others.</td></tr>
</table></td></tr>
<tr><td>3. Loans with competitors</td><td>Ask follow-up questions regarding the bank loans already booked on the financial statements. Information about the loans offered by competitors (e.g., loan type, amount, tenor, original booking date, and purpose) provides insights into the market competition and the client's credit worthiness.</td></tr>
</table>

2.2.2.2 Understand the credit management

1. Prudent procedure for approving credit	***Note to trainers*** *The material below is an example of how the HKMA SPM could be applied directly in the development of the training materials. However, in the assessment questions, the focus should be on the application of these principles.* CR-G-1 which specifies the prudent procedures for approving credit: - Bank should have a written statement (credit manual) setting out the criteria and procedures for granting new credits, for approving extensions of existing credits and exceptions, for conducting periodic and independent reviews of credits granted and for maintaining the records for credit granted - The statement should lay down sound, well-defined criteria for granting credit, including a thorough understanding of the borrower or counterparty, the purpose and structure of the credit and its source of repayment. The same criteria should be applied to both advised and unadvised facilities. - Bank should adhere closely to the “Know your customer” principle and should not lend purely on name and relationship without a firm understanding of the borrower. - Credit decisions should be supported by adequate evaluation of the borrower’s repayment ability based on reliable information. Sufficient and up-to-date information should continue to be available to enable effective monitoring of the account. - All credits should be granted on an arm’s length basis. Credits to related borrowers should be monitored carefully and steps taken to control or reduce the risks of connected lending. - Banks should not over-rely on collateral or guarantees. While these can provide secondary protection to the lender if the borrower defaults, the primary consideration should be the borrower’s debt-servicing capacity. - Banks should be wary of rapid expansion of particular types of lending. This may indicate a relaxation of credit standards and increased focus on more marginal borrowers. - Banks should ensure through periodic independent audits that the credit approval functions is being properly managed and that credit exposures comply with prudential standards and internal limits. The results of such audits should be reported directly to the Board, the Credit Committee or senior management as appropriate.
2. Credit approval, review and records	Refer to CR-G-2 for details.

2.2.2.3 Knowledge in theories and concepts of corporate finance

<table>
<tr>
<td>1.
Generally accepted accounting principles</td>
<td>To a certain extent, the financial statements reflect the intentions and actions of the management (e.g., extended settlement of accounts payable and push, or give incentive, for timely payment of accounts receivable might mean the company has other better alternative uses of the company’s liquidity)

However, there are occasions when the management’s intentions and actions are not visible from the analysis of the financial statements. Critical corporate finance theories will give RPs a broader perspective on a company’s credit worthiness.</td>
</tr>
<tr>
<td>2.
Corporate theories</td>
<td>RPs should sensitize to the discretions taken by the management, which might be within statutory and accounting framework but deteriorates its credit worthiness. Reasons for de-railed management decisions might be explained by corporate finance theory.

The table below shows examples of corporate theories which might explain the management’s decision behaviours:

<table>
<tr><th>Year</th><th>Corporate Finance Theory</th><th>Description</th><th>Underlying Notion</th><th>Alerts</th></tr>
<tr><td>1960s</td><td>Trade-off Theory</td><td>Analysis of benefits and costs deriving from leverage which studies the way in which the firm manage to balance the bankruptcy costs with the benefits of tax shields, derived from taking on debt</td><td>The company sets a target debt ratio which they aim to achieve. i.e., static capital structure.</td><td>A company having a higher debt/equity ratio is risky when the macro-economic environment has a bad turn.</td></tr>
<tr><td>1970s</td><td>Agency Theory</td><td>Study on the conflicting interest between managers and shareholders and between creditors and shareholders</td><td>The shareholders make decisions through agencies, while shareholders are agents for creditors. But creditors have a say in the management.</td><td>A company might not allocate financial resources to riskier investment for higher return, where creditors have no say in the decision.</td></tr>
<tr><td>1980s</td><td>Pecking Order Theory</td><td>Study on information asymmetries</td><td>Less informed investors need an incentive to invest</td><td>Shareholders may be reluctant to risk its own</td></tr>
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</table>

		among investors and firms.	in risky securities. Internally generated funds represent the best financing option, whereas the use of own external capital would be the last financing alternative	capital but not so reluctant with creditors' fund.
1980s 2nd half	SWOT PEST	Study of corporate finance structure based on the factors associated with industrial strategy and corporate organization.	The management band strength, quality of management and industrial strategy has impact on a company's decision on debt-equity mix.	The financial figures might reveal gaps against the representation made by the management
1990s	Trade-off Theory Pecking Order Theory	Continuous research on the prevailing corporate finance theory for more new knowledge		
2000s		Study on capital structure being a consequence of the necessity of marketing timing	Reorientation in research to the empirical analysis of the structure of corporate finance	When borrower has more direct fund-raising channels, there should be careful check and balance on the pricing of the bank's credit offers

3. Corporate finance theories	***<u>Note to trainers</u>*** *Instead of teaching learners one-by-one the theories, trainers might consider having the learners to identify applicable corporate finance theories in the assessment short questions or long questions. Trainers may consider retrieving applicable theories from the "Best Case Handled" presentations shared by learners in class.* Examples of corporate finance theory applicable to the listed company or private companies are:

	Corporate finance theory includes: - Net present value, - Capital Asset Pricing Theory, - Efficient Market Theory - Portfolio Theory - Option Pricing Theory - Agency Theory - Meta-financial theory - Rational Man/Rational Market - Risk and Return - Utility Theory - General Equilibrium - Irrational Man Private market finance theory includes: - Private return expectations, - motives and authority - Value world theory - PPCML - Private options, - inefficient markets - meta-financial theory
4. Examples of applications of corporate finance theories in credit risk management	**Application of Present Value (PV) and Net Present Value (NPV) in Project Financing Analysis** CR-G-12 (credit risk transfer activities) stipulates that "risk measurement methodologies that apply to CRT activities may include internal credit risk rating system, VaR, stress loss. It may also include other sensitivity measures (e.g., the sensitivity of present value to a basis point movement in credit spreads), critical operational risk indicators, and scorecards. Risks not well reflected by standard risk measures should be subject to additional controls, including pre-approval of transactions and specific risk limits". **Application of Capital Asset Pricing Model (CAPM) in Corporate Financing Rate of Return Analysis** The capital asset pricing model describes system risk and expected return for assets. Systemic risk is market risk, the general risk from developments impacting the entire economy and investment assets. For example, interest rates, inflation, recessions, and geopolitical events like war affects system risk. The systemic risk applies to the market, impacting all assets. Non-systemic is also a specific risk unique to each portfolio, which can be reduced by diversification or investing in a basket of different investments. An adequate credit risk management policy should be in place to diversify the risk of the total loan portfolio. **Application of Portfolio Theory in portfolio diversification scenario analysis** Portfolio theory is applicable in credit risk management. For instance, HKMA research covers concentration risk management by applying the concept.
5. Cases	When a company's management deviates from these theories, the outcomes would be detrimental to company management. Here are some related lessons learned from the past.

Management Decision	Case	Outcomes
Trade-off Theory Credit Obligations exceeds equity	Barings Bank	Company round-up
Agency Theory Management misrepresentation on financial situation	Enron	Company round-up

For credit assessment of SMEs, the bank might resort to financial analysis and qualitative evaluation based on the discussion with the company management.

2.2.2.4 Understand and evaluate liquidity, profitability and credit histories of borrowers

The table below summarizes the necessary deep dives to arrive at a critical analysis of financial statements:

<table>
<tr>
<td>1.
Critical analysis on financial ratios</td>
<td>The following are examples of core categories of all financial Analysis:
<table>
<tr><th>Income</th><th>Profit Ratio</th></tr>
<tr><td>Income from core business is higher quality than extraordinary income</td><td>- Return type ratio
- Margin type ratio
- Cost efficiency type ratio</td></tr>
</table>
<table>
<tr><th>Return Ratio</th><th>Margin Ratio</th><th>Cost Efficiency Ratio</th></tr>
<tr><td>Return on assets</td><td>Net interest margin</td><td>Cost-income ratio</td></tr>
<tr><td>Net income/total assets</td><td>Net interest income/earning assets</td><td>Non-interest expense/ pre-provision income</td></tr>
<tr><td>Return on equity</td><td></td><td>Cost-assets ratio</td></tr>
<tr><td>Net income/ shareholders’ equity</td><td></td><td>Non-interest expense /total assets</td></tr>
</table>
Critical ratio regarding willingness of borrowers to service the debt
- Net Income/Shareholder’s equity

Critical ratio regarding capability of borrowers to service the debt
- Debt/Equity
- Net profit ratio</td>
</tr>
<tr>
<td>2.
Critical analysis on financial ratios deviated from industry norms</td>
<td>- Financial ratio analysis reveals inconsistency between income recognition and trade receivable liquidation. The inconsistency could be due to missing information.
- Financial ratio analysis reveals substantial dividend payments which far exceed the industry average. The inconsistency could be due to missing information about the shareholder agreement.</td>
</tr>
<tr>
<td>3.
Critical analysis with authentication of documents</td>
<td>Is the financed merchandise existing in reality and well secured in the warehouse? The existence of inventory needs to be authenticated.</td>
</tr>
<tr>
<td>4.
Critical analysis on the borrower’s</td>
<td>The borrower’s cash flow should be able to fulfill the debt repayment requirements. The table below shows examples:</td>
</tr>
</table>

<table>
<tr>
<td>cash flows and credit repayments</td>
<td>
<table>
<tr><th>Product Nature</th><th>Borrower’s Cash Generation Pattern</th></tr>
<tr><td>• No definite maturity Date (e.g., overdraft)</td><td>• Contingent cash requirements</td></tr>
<tr><td>• Definite maturity date</td><td>• Matched with project income stream</td></tr>
</table>
</td>
</tr>
<tr>
<td>5.
Critical analysis on the borrower’s operational risk</td>
<td>Operations risk – fixed cost/variable cost leverage
Operations risk has a significant impact on the borrower’s income stream stability. Many companies default because their cost structure cannot catch up with necessary changes in the face of competitors and market changes. Competition might prevent companies from transferring costs onto their customers. While price is pushed lower due to competitive forces and cost structure remains inflexible, the profit market squeezes.

<table><tr><td>Vulnerable operations model (industry at stabilized stage) under high inflation environment
P&G 2019 reported quarterly revenue and adjusted profit on July 20, 2019, with a USD8 billion Gillette write-down. Business challenge to Gillette razors, gels and foam worldwide are driven by (1) stronger currency; (2) market competition, and (3) change of habit to shaving less in developed markets. P&G, like other consumer goods companies, has been raising prices on many of its products to tackle soaring freight and raw materials costs that have dented margins. (More information from <u>P&G posts strong sales, takes $8 billion Gillette writedown | Reuters</u>)</td></tr></table>
</td>
</tr>
<tr>
<td>6.
Critical analysis on the borrower’s financial leveraging</td>
<td>Financial risk – debt/equity leverage

<table><tr><td>Financial risk has a significant impact on the willingness of the borrowers to service their debts continuously. High-cost structures also involve the company’s financial system. High leverage poses a problem because the cost of servicing debt remains unchanged while the profit margin squeezes. Companies that rely heavily on refinancing existing debts might have taken for granted the readiness of the banks to renew matured loans. Companies with significant debt-capital ratios should have spread the loan maturity over time so that no single large amount needs refinancing at any point in time.

Vulnerable financial model (economic condition in declining stage and business at fast growth stage) under economic downturn environment

(January 9, 2019) HNA Group has USD50 billion acquisition spree that peaked with the company stakes in banks, fund managers, hotels, property and airlines, among other assets. But</td></tr></table>
</td>
</tr>
</table>

	faced with soaring debt and government scrutiny of aggressive dealmaking, HNA Group has pushed ahead with asset sales that have included real estate and stakes in hotel groups. (More information in HNA sells majority stake in Manhattan building in $422 million deal | Reuters). (June 5, 2021) Creditors seek USD187 billion from bankrupt HNA Group. The Group said some 67,400 creditors are seeking a total of 1.2 trillion yan (USD187 billion). The company has confirmed 405.7 billion yuan in claims as valid and has rejected 353.5 billion yuan in claims. Another 156.5 billion yuan in claims are being assessed as part of a preliminary review while some claims have yet to be reviewed. (More information in Creditors seeking $187 bln from China's bankrupt HNA Group – executive quoted | Reuters)

(7) Implications from cash flow analysis

There are several implications from the outcomes of cash flow analysis.

- To understand, directly from the analysis, whether the borrower can meet the cash repayment requirements in the relevant period
- To understand, indirectly from the analysis, whether the shareholders have sufficient incentive to service the debt payment on time according to the loan covenants

(8) Default scenarios other than cash flow issues

The table below introduces some situations where default occurs before bringing out the cash budget and cash flow analysis:

Debt Service Default	Technical Default	Sovereign Default	Strategic Default
When a borrower is unable to pay a loan and will not keep it from going into default status	When a borrower does not meet a condition of the loan, which is not related to non-payment	When a country could not make payment according to the loan covenants	A borrower has the ability to pay but purposely refuses to make payment

The cash budget and cash flow analysis deal with assessing the ability to pay rather than the willingness to pay or the technical non-fulfillment of loan covenants.

(9) Constraints on cash flow analysis

Methods to establish cash flow stream

The direct method is more precise but requires more effort to gather the necessary information. On the other hand, the indirect approach requires relatively less effort to gather the essential information as the figures for listed companies are readily available in the annual report.

Direct Method	Indirect Method
The direct method uses actual cash inflows and company operations outcomes.	The indirect method modifies the operating section from accrual accounting to cash. It always begins with income.

Historic data

This section should articulate the cash flow statement analysis's limitation with the financial statements' limitation. Regarding the application of the indirect method, all the data on the financial statements are historical data which might not imply that the same will happen in the future. Besides, the financial statements periodically capture necessary data and information while the underlying transactions happen daily.

F Holdings Limited

Consolidated Statement of Profit or Loss and Other Comprehensive Income

	2021	2020	2019
	HK$'000	HK$'000	HK$'000
Cash flows from operating activities			
Profit before tax	138,399	72,080	215,172
Adjustments for:			
Depreciation for other property, plant and equipment	100,865	103,915	105,263
Depreciation for right-of-use assets	443,234	430,247	-
Amortisation of interests in leasehold land held for own use under operating lease	-	-	212
Impairment losses on other property, plant and equipment	34,310	8,340	10,221
Impairment losses on right-of-use assets	59,377	17,498	-
Finance costs	36,824	37,995	32
Interest income	(4,437)	(10,862)	(10,227)
(Reversal of)/Provision for long service payments made	(1,668)	8,308	7,307
Net loss on disposal of other property, plant and equipment	9,779	6,440	3,300
Valuation losses on investment properties	8,570	5,750	1,880
Equity-settled share-based payment expenses	2,303	1,577	2,512
Others	(1,597)	(1,128)	-
Operating profit before working capital change	825,959	680,160	335,672
Changes in working capital:			
Decrease/(Increase) in inventories	4,819	(17,268)	6,940
Decrease/(Increase) in rental deposits paid	2,494	(6,427)	(4,725)
Increase in trade and other receivables	(7,116)	(12,028)	(7,261)
Increase/(Decrease) in trade and other payables	(39,640)	31,110	(7,044)
Increase/(Decrease) in rental deposits received	(342)	2	99
Provision for long service payments utilised	(1,251)	(1,755)	(1,141)
Provision for reinstatement costs utilised	(3,709)	(221)	(1,230)
Cash generated from operation	781,214	673,573	321,310
Interest received	4,701	11,216	10,110
Interest paid	-	-	(32)
Tax paid	(5,126)	(40,671)	(40,107)
Net cash from operating activities	780,789	644,118	291,281
Cash flows from investing activities			
Purchase of other financial assets	-	-	(22,839)
Purchase of other property, plant and equipment	(109,878)	(128,015)	(114,964)
Net proceeds from disposal of other property, plant and equipment	299	97	31
Proceeds from maturity of other financial assets	3,100	11,366	14,635
Decrease/(Increase) in bank deposits with more than three months to maturity	(6,511)	-	51,484

Capital element of lease rentals receipt	1,524	-	-
Interest element of lease rentals receipt	116	-	-
Net cash used in investing activities	(111,350)	(116,552)	(71,653)
Cash flows from financing activities			
Proceeds from issue of shares	-	18,268	20,780
Expenses incurred in connection with the issue of shares	-	(24)	(48)
Payment for share repurchase	-	-	(3,858)
Dividend paid	(103,627)	(134,715)	(182,805)
Repayment of bank loan	-	(143)	(1,720)
Capital element of lease rentals paid	(424,974)	(380,792)	-
Interest element of lease rentals paid	(36,824)	(37,995)	-
Net cash used in financing activities	(565,425)	(535,401)	(167,651)
Net increase/(decrease) in cash and cash equivalents	104,014	(7,835)	51,977
Cash and cash equivalent at start of the period	511,047	519,854	469,113
Effect of exchange difference	571	(972)	(1,236)
Cash and cash equivalent at end of the period	615,632	511,047	519,854

*** Use of indirect method**

2.2.2.5 Evaluate financial statements and identify incomplete information

<u>(1) Knowledge on industry cycles</u>

<u>Note to trainers</u>

RPs should have an overall understanding of the industries to lead to a profound knowledge of the business models. In addition, they should be able to interpret research report findings and articulate the external risk factors, to deepen the understanding of the financial analysis. For example, trainers may provide an industry research report link in the assessment with an extended question as background information to supplement the depth of the financial analysis on borrowers from a specific industry.

Additional resources for trainers:

Examples of reliable economy and industry information

- Research commissioned by Government and other reliable organizational sources
- Research commissioned by Industries
- Specialist research by Global Organizations
- Inhouse economist and industry research by the bank
- Industry network through the frontline marketing officers
- Customer network through the frontline marketing officers

<u>Industry cycle</u>

A company's forecast/budget should be prepared within the company's context and the industry cycle. A company's forecast could be easily detected if contrasted with the industry cycle development. There are five life stages described in the table below:

Industry Cycle		**Degree of Profit uncertainty**	**Market Growth Potential**	**Customer Group**	**Growth Pace**	
					Market Share Growth	**Tech Start-up**
1	Exploratory stage	High	High	Opinion Leader	Slow	Fast
2	Rapid growth	High	High	Early Adaptor	Rapid	
3	Maturity growth	Low	Low	All Customers	Slow	Slow
4	Stabilized stage	Low	Low	Customers starts to leave	Stagnant	Stagnant
5	Decline Stage	Low	NIL	Customers leaving fast	NIL	NIL

<u>Industry KPIs</u>

<u>Note to trainers</u>

Trainers may consider comparing the disclosure of the KPIs of listed companies and contrast these KPIs with the industry norm to provoke discussions among the learners.

Analysis of a company's forecast/budget KPI should show that the KPIs align with the industry KPI. A borrower should thoroughly explain the significant deviation from the industry norm. RPs could compare a borrower's KPIs with the industry benchmark to identify variation requiring attention.

2.2.2.6 Site visits and critical financial analysis

(1) Values of site visits

There are multiple values of site visits. The table below give examples of circumstances when a site visit provides valuable inputs:

	Timing of Site Visits The shorter and the more regular the better to avoid surprises		
Purpose	Before credit proposal submission	During loan life after the loan was approved	Under special circumstances when ad hoc visit is demanded
1	**Cross-verify financial information** To ascertain that the information provided on the financial statements are usable for financial strength and cash flow analysis	**Cross-verify financial information** To ascertain that the information provided on the financial statements are usable for financial strength and cash flow analysis	**Cross-verify financial information** To ascertain that the information provided on the financial statements are usable for financial strength and cash flow analysis
2		**Early warning Signals** To identify any early warning signals reflecting changes in credit quality.	
3		**Deepen relation with friendly reminders** To establish a friendly relationship with the borrower by following up for missing and incomplete information, the act of which improves the quality of information on the financial statements for the coming loan renewal.	
4			**To verify situation changes not yet reflected on the financial statements** To ascertain that the information not yet provided on the financial statements is usable for financial strength and cash flow analysis

<u>(2) Checklist for site visits</u>

Prepare the checklist and have it handy for starting conversations with the business owners or the business managers. Update the visit checklist before each visit. Check off the items on the list and take digital photos for future reference.

Complete the site visit report and highlight striking findings supported by the explanation given by the business owners or business executives. The two tables below show examples checklist for site visits:

Take Digital Photos	Lease Location	List of Original Collateral
- Exterior of the building - Interior of the building - Adjacent properties - Specific collaterals	- Landlord's contact information - Status of lease arrangement - Condition of the lease premises	- Physical condition of storage - Warehouse controlled conditions

List Collaterals on The Site	Real Estate is the Collaterals	Retail Business
- Compare to original collateral - Obtain explanation of differences - Note the collateral labels - Eliminate current liquidation value of collaterals - Confirm identification number of valuable items - Obtain inventory list	- Note property condition - Note the potential environment issues - Exterior signage - Signs of deferred maintenance - Condition of the neighborhood	- Stocked shelves - Customer purchases - Competitor in immediate vicinity

<u>(3) Powerful site visits to authenticate documents</u>

The table below shows two examples where site visits reveal company scandals on "funning" the annual reports or financial statements:

Company	Investigative Outcomes of Site Visits	End Game
Accessories retail chain stores	Phantom shops	***<u>Note to trainers</u>*** *Trainers may discuss these cases as icebreaking in the Newsroom learning activities.*
Coffee chain stores	Video recording of foot traffic outside shop revealed phantom traffic	

2.2.3 Critical analysis of financial statements (external factors)

2.2.3.1 Knowledge of the bank's portfolio, economic research, and industry research

(1) External risk factors

Note to trainers

Trainers should sensitize learners regarding the dynamics of the external factors critical to industries' performance. The table below show the multi-dimension of the external factors:

Economic Conditions	Inflation and Deflation	Balance of Payment and Foreign Exchange
Private consumption	Higher level of inflation	Devaluation of currency
Government spending	Lower level of inflation	Appreciation of Currency
Investment		
Imports and exports		

Political Situation	Fiscal Policy	Monetary Policy
Government changes and subsequent changes in policies which may cause serious troubles for the long-term plans of businesses	Different products of fiscal policy, such as taxation, surcharges, disinvestments, levies, duties, tariffs, borrowings and a host of other tools to raise government revenue	Government controls the money supply in the economy to achieve various goals such as stability in price levels and foreign exchange rates and an economic atmosphere conducive to growth
Political events caused by other vested interests e.g., violence, terrorism, riots, and so on		

Demographic Factors	Regulatory Framework	Technology
Characteristics of the population has immense significance for business Examples are: - Age - Birth rate - Gender	Another source of operating risk is the number of regulations imposed on business and penalties for non-compliance	The cost of production under the current production technology might later become non-competitive because of the new technology employed by competitors.

(2) Articulation of external risk factors

Note to trainers
Trainers may cite examples regarding the degree of impact of the external factors on different industries.

Credit risk analysis is a comprehensive and highly articulated approach to line up dots scattered with a borrower to become a big picture to reflect its risk level. The analytical framework below lists out the risk factors mentioned in previous sections. It facilitates the aggregation of all risk factors to the corporate risk of a borrower. The table below shows examples of various risk factors:

External Risk Factors			
Systematic Risk	**Industry Risk**	**Market Risk**	**Technology Risk**
Risk factors Economic factors Demographic factors	**Risk factors** Government regulations Industry cycle	**Risk factors** Business models to survive/beat the market	**Risk factors** Substitution technology
Lessons learned COVID19 outbreak consequences in company wind-ups	**Lessons learned** Market share of conventional energy sources taken up by green energy and nuclear energy	**Lessons learned** Shared economy has lowered the entrance cost to the retail market competition	**Lessons learned** Conventional internet with cables replaced by satellite wireless network

Entity Risk Factors			
Operational Risk	**Legal Risk**	**Reputation Risk**	**Liquidity Risk**
Risk factors Economic factors Demographic factors	**Risk factors** Government regulations Industry cycle	**Risk factors** Business models to survive/beat the market	**Risk factors** Substitution technology
Lessons learned Barings bank bankruptcy due to one single traders' transaction	**Lessons learned**	**Lessons learned**	**Lessons learned**

Industries significant impacted by change of external factors	**Industries** moderately impacted by the change of external factors	**Industries** slightly impacted by the change of external factors
Examples Civil Aviation Retail	Telecommunication Information Technology	Utilities Healthcare

(3) Interpret research findings

Research on significant past credit cases

Note to trainers
Trainers may share significant credit cases to indicate the potential impact of external risk factors.

Example
The Walt Disney Project in Paris, France, is a well-known case with lessons learned about the impact of external factors. The "Euro Disneyland project" was a star project syndicated by hundreds of banks. According to the project plan, the repayment sources are 50% from the real estate property development and the other 50% from the theme park. However, the European economic downturn had caused the project never to realize the specific planned income. Together with other external factors, the project cost was almost four times the planned debt. It ended up structuring the shareholdings of the project to take in a new major shareholder for further funds to continue the project. The HKSAR government had financial meetings to go through lessons learned[45] from this case before it decided on the participation and construction of the Disney Hong Kong project.

RPs should be able to link external risk factor changes to project, entity, and sector performance as they are highly related. The external risks could impact the repayment sources of the borrowers, hence their repayment capability, to a very significant extent. Looking for substantial credit cases of the past within the banks is one of the relevant means to identify external factors with a considerable impact on the credit performance of an account/an industry.

[45] Information Note, Disneyland Paris: Some Basic Facts, Liu and Wong, 10 November 1999, Legislative Council Secretariat, 990in01.pdf (legco.gov.hk)

2.2.4 Critical analysis of financial statement (Business Model)

2.2.4.1 Interpret financial statements to determine financial standing of borrower

(1) Limitation of financial statement analysis

Financial analysis is an effective tool to determine borrowers' financial standing. However, RPs need to answer one more important question, "How sustainable is the financial standing?"

(2) Analysis of business models to supplement financial analysis

RPs should perceive the borrowers' business models based on the financial analysis and validate that against the business models presented by the borrowers during interviews.

There are a variety of business model analysis tool which might be embedded in the Module assessment.

- SWOT
- 5C
- Business Canvas

Business models can involve overly optimistic assumptions about the demand for a product or the ability of the company to cross-sell across its product line. However, just take an example in the service industry, changes in consumer habits to online shopping at the expense of the physical shop model have caused bankruptcy or simply closure.

Additional Resources for Trainers:

Example of business model (Industry decline stage) vulnerability with changes in customer behaviours:
UK Department Store Group Debenhams set to close all its UK shops after 242 years in business, as the second major corporate failure since the outbreak of COVID19. However, even before the pandemic, brick-and-mortar retailers in Britain faced a significant structural challenge, with the economics of operating stores on traditional leases proving increasingly difficult as more trade migrates online.

2.2.4.2 Apply suitable method to calculate the value of business

Quantitative analysis to supplement business model analysis

Financial statements and business model analysis are primarily based on historical information. RPs should follow up with the borrowers on the initiatives that impact the future cash flow and perform independent verification (e.g., public domain news about the borrowers).

Identification of the borrower's business outlook helps the credit risk assessment. Examples of quantitative analysis include

- Cash Flow Analysis for understanding the net cash position with a future period
- Discount of the cash flow with adequate opportunity investment return to understand the break-even
- Stress testing the cash flow to identify vulnerable situations when a borrower's debt servicing capability decreases significantly
- Sensitivity analysis validates the verbatim provided by the borrowers regarding the future potential of the income stream.

2.3 Submodule 3: Structure Credit Facility

Note to trainers
Trainers can pick, change, and repackage the content sample below according to learners' needs

2.3.1 Introduction

In the IPO press release of L-Coffee Inc on May 17, 2019

"L-Coffee Inc (NASDAQ: L-) has pioneered a technology-driven new retail model to provide coffee and other products of high quality, high affordability, and high convenience to the customers. Empowered by big data analytics and proprietary technologies, the company pursues its mission to be part of everyone's everyday life, starting with coffee. The company was founded in 2017 and based in China."

When researching information of the company, RPs should have questions that pop up to trigger investigations on the big picture:

- What strategies are adopted to enable the growth from zero to scale qualified for IPO within two years?
- What are the differentiating factors in the strategies that beat all other competitors, including Starbucks?
- What are the underlying proofs of the claimed differentiating factors?
- How would you know if the company will be able to maintain its leading market share?
- What investment would be required to sustain the growth pattern?
- Assuming the company can maintain a leading market share, what return on investment can be expected under the market situation?

The ultimate question is: Will you lend your money to this company?

2.3.2 Budget and pro-Forma analysis

2.3.2.1 Understand the characteristics of different credit products

<u>Note to trainers</u>
Learners going through Submodule 3 already possess the pre-requisite knowledge and skills from Submodules 1 and 2.

2.3.2.2 Evaluate method to compute client's ability to repay loan

Non-listed companies are not subject to disclosure of cash flow status and requesting one to identify associated risk on the cash status in the relevant coming period is necessary. Listed companies include cash flow statements in the annual report but are less flexible in providing monthly, quarterly, or semi-annual cash budgets. However, RPs who invest time in analysing financial statements of various industries will groom a forward-looking view with the articulation of historical information and the latest industry updates.

<u>(1) Analysis to help clients to identify client's purpose and objectives for loan demands</u>

A borrower's precise needs might differ from the fundamental financing needs. Critical financial analysis helps deep dive into the business's strengths and vulnerability. This information allows RPs to judge whether the loan is adequate to support the essential business drivers for sustaining/growing the income stream.

Also, a borrower's business performance includes both inherent risk specific to the company and the systematic risk general to all the companies within the same industry/sector/geography/economy. Multiple correlations are causes of cyclical movements and contagion effects.

Cashflow projection and analysis help RPs to contain the business complexity in different scenarios to explore possible alternatives in the loan arrangement.

<u>(2) Suitable methods for budget and pro-forma analysis</u>

The application of analytical information is continuously evolving. Therefore, RPs should identify the most suitable tools for financial statements and cash flow analysis, dependent on the sophistication of the borrower's business and the bank's business.

However, disregarding the tool used, RPs should adopt the investigative approach to follow up on missing information, disguised information, and data authentication.

	1900s	1940s	1970s	2000s
New analytical tools	Balance sheet analysis	Income statement analysis	Funds Flow Statement	State of art analysis
Analytical outcomes relevant for credit risk analysis	To reveal financial strength	To reveal income generation capability	To reveal the cash generation capability	Risk Modelling

(3) Monitoring of cash generation/preservation capability

Highly demanding on RPs' articulation skills
Credit risk assessment requires an articulated analytical process regarding various levels and aspects of borrowers' risks. For example, companies that default on payments have a flaw in their business models (business risk), cost structure (operation risk), or financial structure (financial risk). Because of accounting information asymmetry, the credit risk assessment should adopt an investigative approach to identify the existing and potential future flaws in the above areas.

Familiar with the borrower's industry
One of the viable bank strategies is to specialize in loans to designated sectors/industries. Specialization enables a bank to cumulate experience on relevant risk assessment and may lower the credit risk in the long run. The problem, however, is the lack of expertise to perform a risk assessment on other loans when the customers' needs evolve.

Monitor the cash flow
Even though critical financial analysis reveals a company’s financial strength, a borrower’s cash flow is crucial to repay the obligations. Therefore, credit analysis tools assess the borrower’s ability to generate cash flow for debt servicing. The following analytical framework gives an example overview of evaluating a borrower’s cash generation/conversion capability during the credit risk assessment process.

Analysis	Credit Risk Assessment Stage	Analytical Tools	Function of the Analytical Tool
Financial ratio analysis	New loan application Renew loan application Regular review	**Interest cash coverage** i.e., “net cash from operations” to “interest paid” ratio	Shows how much cash is generated from the operations to cover the interest obligations
		Short term debt coverage i.e., “Net cash from operations – interest – tax” to “overdraft + Short Term Loan” ratio	Shows how much “excess” cash from operations remains in case all short-term debts (overdraft plus short-term loan) are repaid
		Dividend cash coverage i.e., “Cash from Operations – Interest – tax” to “Dividend Paid +Dividend Declared”	Shows that the dividend is paid from the cash generated from operations, rather than from bank borrowing
Working capital analysis	New loan application Renew loan application Regular review	**Changes in working capital** i.e., Changes in the level of -stock -debts -current assets -accounts receivables -other current receivables	An increase in the working capital level means cash is taken up to fund it A decrease in the working capital level means cash is released from it
Changes in profit margin	New loan application	**Changes in payment terms**	Market competition may pressure the company to

	Renew loan application Regular review	Favorable payment terms to a borrower reduces the cash requirements. Unfavorable payment terms to a borrower increases the cash requirements.	change to unfavorable payment terms to retain the business from the customers Supplier's power may pressure the company to change to unfavorable payment terms to keep constant supply from the suppliers
Changes in profitability	New loan application Renew loan application Regular review	**Changes in profitability** e.g., profit before income and tax, net profit	Increase in profit releases additional cash
Loan covenants	Loan administration	**Loan covenants may cover requirements on** Return on capital	To ensure that borrowers' shareholders have incentive to put in new capital for business expansion etc.
		Loan covenants may cover requirements on Interest cash cover	To ensure that borrowers have ability to service debt
		Loan covenants may cover requirements on Fixed charge coverage by operational cash (e.g., leasehold agreement, interest)	To ensure that borrowers have incentive to continue the business operations
		Loan covenants may cover requirements on Dividend cash cover dividend pay-out	To ensure that borrowers' payment of dividend is not paid out of debt To ensure that the borrowers' shareholders have incentive to continue business operations
		Loan covenants may cover requirements on Directors' dues/loans, intercompany dues/loans	To ensure that the loan is disbursed for the purpose intended at application
		Loan covenants may cover requirements on Management fee	To ensure that the management fee is paid out only after the debt obligations are met

(4) Cash budget and SMEs

For SMEs, cash budgeting is a practical tool for communication between borrowers and banks. In addition, cash budgeting on a pre-set time frame continuously helps monitor the cash position to ensure that the debt servicing capability is well ahead. Moreover, the borrower provides the cash budget for the credit risk assessment.

(5) Purpose of a cash budget

Understanding	Monitoring	Improvement	Coordination
For understanding the cash positions within the required time frame	For ascertaining whether company operations and other activities will provide cash flow to meet the debt servicing or other cash requirements	For simulating re-allocation of cash receipt pattern and disbursement pattern to reserve cash for debt servicing or other cash requirements	For monitoring the excess cash balance in the financing budget and a shortage of cash balance is remarked in the financing budget to identify the amount of debt needed to offset these shortages

(6) Sample format of a cash budget

A cash budget is a financial planning tool prepared by borrowers to predict when itemized cash will come and leave the business. The table below shows an example:

Cash Budget

Cash budget Month 1 to month 4, 202X	**Month 1**	**Month 2**	**Month 3**	**Month 4**
Cash receipt				
Cash Sales				
Cash collected from credit sales				
Cash collected from sales of non-current assets				
Cash receipt from loans				
Cash receipt (others)				
Total receipts				
Cash payment				
Cash payment				
Credit purchase (not using cash)				
Cash payment for expenses (e.g., rent)				
Cash withdrawal				
Cash purchase of non-current assets				
Cash repayment of loans or debentures				
Cash repayment (dividend)				
Cash repayment (interest)				
Cash payment (others)				
Total payments				
Net cash increase/decrease				
Bank balance – beginning of period				
Bank balance – end of period				

(7) Non-cash items

The table below shows examples of non-cash items to be excluded in the cash budgeting:

Tax	Acquisition	Compensation	Operations	Provision
Deferred income tax	Write-down values of acquired companies	Employee stock-based compensation	Depreciation Amortization	Bad debt

(8) Preparing cash budget

Borrowers may track a small number of or small cash items with excel spreadsheets in simple steps. However, if the number of items is enormous, the borrowers must apply information technology. The table below shows an example of the cash budgeting process:

Step 1	Step 2	Step 3	Step 4
Prepare key ingredients for input -Time frame -Target cash position -Sales and Expenditure	Itemize relevant amount and post as -Cash inflow -Cash outflow	Compare the cash budget with -Real cash position -Target cash position	Make management decisions -Renew cash -Reduce cash outflow -Increase cash inflow

(9) Advanced budget and pro-forma analysis

Preparing advanced budget and Pro-forma analysis

Pro-forma financial statements have different definitions according to various contexts. The table below shows some examples:

Perspective	Explanation	Usage
Stakeholder engagement	Pro-forma financial statements leverage on hypothetical data or assumptions about future values to project performance over a period that hasn't yet occurred[46]	Presenting a view to engaging stakeholders to better understand a company's performance over a specified period -Projecting investment return -Show expected results before the end of the reporting period
Corporate finance	Pro-forma financial statements are financial reports issued by an entity, using assumptions or hypothetical conditions about events that may have occurred in the past or the future [47].	Presenting a view of corporate results to outsiders as part of an investment or lending proposal

[46] What Are Pro-Forma Financial Statements? | HBS Online
[47] Pro-forma financial statements definition — AccountingTools

(10) Quality budget and pro-forma analysis for key stakeholders

Understanding the types of pro-forma statements helps RPs to ask good questions to ascertain the quality of budget and pro-forma analysis and identify key business drivers, missing information, information gaps, and future business outlooks. The table below describes the budget and pro-forma analysis:

Types	Description	Purpose	Stakeholders
Budget	- A budget is a variation of pro-forma financial statement with a one-to-three-year time frame to present the projected results of corporations during a future period. - The resulting statement will usually be one set of documents for collaboration within the organization.	- For borrowers to make management decisions on the timing and the pacing of changes if allowed within the accounting rules	- Internal management - Investors - Creditors
Investment projection	- Investment pro-forma projection over a relevant future time frame shows how the company results will change with the investment of a certain amount. - The resulting statement might have several scenarios of the market situation or investment level or variations with both.	- For borrowers to engage the investors about the outcomes for different levels of investment	- Investors - Creditors
Acquisition	- Borrowers' pro-forma statements show the events that happened in the past over a meaningful past time frame. - For instance, pro-forma statements should include the net profit of a planned acquisition that happened in the past over the relevant past time frame - The resulting statements might project backward with different time horizons with meaning to the acquired targets and the acquiring investor.	- For borrowers to engage for potential funding	- Investors - Creditors

Risk analysis	- Borrowers prepare pro-forma statements with a relevant time frame with the base case, best case, and worst case. - The resulting statements will vary according to the management decisions and the scenarios presented by the risk factors.	- For borrowers to engage the creditors for elevation of confidence	- Creditors
Accounting adjustment	- Borrowers should prepare pro-forma statements over time with compulsory reinstatement of figures to review the impact of accounting standard changes.	- For borrowers to make management decisions on the timing and the pacing of changes, if allowed within the accounting rules	- Internal management

(11) Limitation with the pro-forma financial statement analysis

RPs should review the assumptions of pro-format statements with prudence principle because the general borrowers submitting the pro-format statements intend to show a brighter future. The table below compares the features of financial statements and the pro-forma statements to alert the RPs about the high required standards of the latter:

Features	Financial Statements	Pro-Forma Financial Statements
Accounting standards	Applicable	Applicable
Reporting standards	Applicable	Applicable e.g., Listing rules applies for listed companies
Transaction captured	Transactions of the past	Including e.g., reinstated transactions of the past e.g., projected transactions into the future
Assumptions	Mostly capturing the actual transactions Some of the figures are estimation e.g., loan provision Some of the figures may be affected by arbitrary cut-off date e.g., a significant bank loan matured on Dec 31, 2021, will be shown on Dec 31, 2021, but not on Jan 1, 2022 (The above might lead to a significant swing of debt/equity ratio).	Mostly assumption-based e.g., economic conditions e.g., sales momentum e.g., cost of materials e.g., staff turnover rate
Calculations	Most items are direct captures from historic information. Some items are estimates: e.g., month end e.g., average	Most items are calculated: e.g., formula-based at month end (e.g., commercial mortgage outstanding amount is calculated based on re-payment schedule) e.g., average sales figures

Compliance for listed companies in Hong Kong[48]

RPs should sensitize to the requirements on pro-forma statements imposed on certain corporations. The following is an example of one of the rules:

"Where an issuer includes a pro-forma financial statement in any document, whether or not the Exchange listing rules require such disclosure of pro-forma financial information, that information must comply with laws, and a report prepared per regulations should show up in the relevant document."

[48] Where an issuer includes pro-forma financial information in any document (whether or not such disclosure of pro-forma financial information is required under the Exchange Listing Rules), that information must comply with rules 4.29(1) to (6) and a report in the terms of rule 4.29(7) must be included in the relevant document.

2.3.2.3 Assessment on specific projects

(1) Verifying the quality of the cashflow

Practically all pro-forma statements show growth in the business. However, RPs should perform a few things to verify the growth outlook and sustainability.

- Authenticate the contracts of the borrower's significant clients
- Analyse the sources and causes of growth (e.g., from business operations or financial operations)
- Articulate the sources and causes of development with the government regulation changes, macro-economic and industry outlook
- Compare to pro-forma (and actual achievement) of similar projects/assets already financed by the bank.
- Engage the bank's industry consultant to assess the quality of the project/asset-generated cash flow

(2) Estimating cash flow gaps without the loan

RPs are discouraged from lending more than the borrowers' needs. When borrowers apply the whole of the loans to assessed credit purposes, the additional credit risk mitigates. The cash flow schedule helps identify the amount and timing of gaps that require financing. It also reveals the borrower's affordability of the loan repayment. The assessed credit risk level is higher if the cash flow gaps extend further into the timeline.

(3) Quantifying the time uncertainty of repayments

The discounted cash flow method considers the money's time value in arriving at the breakeven estimation. With this method, RPs mitigate the uncertainty caused by the time factor to provide a clear business outlook for credit risk assessment. The assessed credit risk is higher if the analysis shows that the borrower does not achieve breakeven within the relevant time frame.

RPs refer to credit guidelines or approving parties for the discount rates applied for cash flow analysis. The rates may depend on various factors, such as the sources of repayment. The table below shows some examples of the discount rates:

Sources of Repayment	Discount Rate
Project income	Borrowing cost of alterative financial instruments
Company's overall income	Weight rate of equity and debt financing

(4) Estimating the achievability of the cash flow drivers

Cash flow analysis must include explicit assumptions on cash flow drivers, subject to validation and confirmation. Highly cyclical industries are particularly vulnerable in an economic downturn. Therefore, RPs should consider the impact of the economic cycle on the cash flows in the construction of the cash flows. The table below shows some examples of factors with impact on cash flow projections:

Variables of External Environment	Variables of Business Environment
- GDP Growth - Inflation Rate - Labor Cost - Commodity Price	- Market Share - Market Potential - Channels - Customers - Transactions - Price - Productivity

2.3.3 Quantitative Analysis and Risk Assessment

2.3.3.1 Assessment by evaluating the business risk, financial risk, and total corporate risk

(1) Risk assessment on qualitative risk factors and quantifiable risk factors

Credit Assessment includes qualitative risk factors, which are still quantifiable (e.g., with scores on impact to risk quality), and quantitative risk factors. The table below shows some examples:

Qualitative Analysis	Quantitative Analysis
- Analysis of the legal title of the collaterals - Analysis of the quality of the management - Analysis of the market competition **Remark** Eventually, the qualitative analysis outcomes would be assigned a value for applying the quantitative analysis method. e.g., internal credit rating includes both outcomes from qualitative analysis and quantitative analysis, with a value assigned to the credit quality, such as one as the best and five as the worst credit quality	- Financial ratio analysis - Cash budget analysis - Cash flow analysis **Remark** The outcome of the analysis is values or statistics

Estimate the degree of risk involved in the loan

To arrive at a preliminary credit risk assessment, RPs carefully construct the cash flow schedule with distinct cash flow from core business income, core business leverage, core financial income, core financial leverage, and overall borrower's management quality to sustain the business income.

2.3.3.2 Calculate the cost of offering the loan

Cost factors of loan offering

Note to trainers

Banks have different dynamics in the cost factors. Trainers might consider obtaining the cost factor summary from the bank and embed that as an information sheet provided in the assessment with short or long questions.

The table below lists out some examples of the cost factors related to loan offering:

Provided by	Funding Cost	Overhead Expenses	Administration Cost
Treasury	The base rate before adding the risk premium		
Financial control		The overhead allocation is related to all other functional units' hardware (e.g., premises rental, maintenance, data storage, and others) and software support (e.g., external customer and internal customer servicing) to the available Credit units.	
Credit administration			The administration cost varies depending on the loan type, the transaction frequency, the T&C, the collateral valuation cost, and other factors.

2.3.3.3 Calculate the amount to be allocated to loan loss reserve

Note to trainers

There is a statutory requirement on the loan loss reserve and capital charge allocation. However, banks have various fine details regarding the fulfilment. Therefore, trainers might consider obtaining an allocation summary and embedding that as an information sheet provided in the assessment with short or long questions for learners' reference. The following is a summary of the factors to be considered.

The table below shows the sources of information relevant for calculating the amount to be allocated to the loan loss reserve of a credit application:

Loan loss reserve and capital charge allocation

The table below briefs the loan allocation and capital charge allocation provided by the appropriate department:

Provided by	Loan Provision Allocation	Capital Charge Allocation
Financial control units	Specific loan provision depends on the internal credit risk rating, which is, in turn, a result of Default risk and recovery expectation.	Capital charge allocation of the specific loans may arrive with the weighted exposure at the default of the loans.

2.3.3.4 Provide recommendations regarding the affordability of the client

Client's affordability – factors for consideration

Note to trainers

Trainers may obtain cash flow analysis (projection before project starts and actuals after project starts) from the bank and provide that as background materials in Assessment with short or long questions to sensitize the learners that cash flow projection assumptions before the project starts and the reality after the project starts could have a significant disparity.

Critical financial and cash flow analysis provides essential insight into the borrowers' affordability of repayments. The table below shows some examples of consideration when evaluating affordability:

Sources of Information	Primary Source of Repayment	Financial, Operations, Business Strength	Other Considerations
- Outcomes of critical financial analysis - Cash flow analysis	- Repayment depends on the revenue of a single project/ product/geography, - Repayment depends on the total business revenue	- The quality and liquidity of the balance sheet items - The operations leverage and the financial leverage of the business	- The collaterals and guarantees - The total business relationship with the borrower and its group company

2.3.3.5 Pricing and risk of repayment

(1) Credit risk express in figures

The table below shows the commonly used credit risk indicators reviewed by banks with adequate resources on data collection and information tools:

Exposure	Default Probability	Probability of Recovery
EAD Exposure at risk	**PD** Probability of Default/ Default Probability	**(1-LGD)** Recovery probability with the Loss Given Default

(2) Internal credit risk rating reflects the credit risk

Note to trainers
Trainers may use this section to mention the goals of the Basel Accords, which promote safety and soundness while considering the competitive environment for banks of different degrees of sophistication. Trainers may use this opportunity to include the relevant corporate finance theories related to risk-free rates and risk premium in the Assessment with short or long questions. Banks have adopted risk-pricing models with various assumptions. Trainers may request the Bank to provide relevant indications in the credit risk policies or other sources of information for learners' reference in the related Assessment.

2.3.4 Structure credit facilities

2.3.4.1 Professional knowledge in corporate credit management

Note to trainers
Trainers may use this topic to design an assessment with short and long questions. The assessment will help learners be aware of the importance of reviewing the credit applications with keen reference to the bank's credit policies while keeping a broader perspective of the corporate credit management principles.

Applicable corporate finance theories and concepts at this stage of the credit analysis process would be cash flow project, present values, net present values, and the capital asset pricing model.

2.3.4.2 Professional knowledge in corporate loan financing

Note to trainers

Trainers may refer to submodule 2 and embed assessment with short or long questions with scenarios with different products.

RPs should possess practical corporate loan knowledge for the credit analysis process regarding project finance and syndicated loans from credit applicants of various industries such as

- the shipping industry
- the petroleum and oil refinery industry
- other industries

which demand substantial loan amounts and a long pay-back period.

2.3.4.3 Estimate the degree of risk involved in extending credit

After financial ratio analysis, critical financial analysis, and business model analysis to understand the key business drivers, RPs have good ideas about the preliminary risk level of the concerned loan application. Throughout the analysis, RPs should have integrated the corporate finance knowledge into the loan risk evaluation.

(1) Analytical framework to validate if current assessment method satisfies the lending criteria

The analytical steps listed below are relevant for the preliminary risk assessment with an evaluation of business risk, financial risk, and total risk:

Step (1) Assess the specific risk of the borrower[49]

The risk assumed by a bank should be commensurate with the return. Therefore, the risk level assessment must include a critical analysis of the **willingness** of the borrowers to pay and the **capability** to comply with the obligations.

Banks have templates to guide RPs in analysing borrowers' business risk, financial risk, operational risk, and financial strength. RPs make use of all the financial analysis tools to understand the specific risk assumed by the borrower. The table below shows some examples of using financial analysis to estimate the type of risk and level of risk banks take up if concerned loans are approved:

[49] *For more financial ratios, online resources are available. Here is one online link: Financial Ratios – Complete List and Guide to All Financial Ratios (corporatefinanceinstitute.com)*

Financial Ratios	Internal Credit Rating				
	Total Corporate Risk				Financial Strength
	Business Risk	Financial Risk	Operational Risk	Liquidity Risk	
Profitability ratio – gross profit margin			X		
Profitability ratio – operating margin			X		
Profitability ratio – other income ratio			X		
Profitability ratio – net profit margin			X		X
Liquidity ratio – current ratio				X	
Liquidity ratio – quick ratio				X	
Liquidity ratio – cash ratio				X	
Solvency ratio – debt/equity ratio					X
Solvency ratio – interest bearing debt to assets				X	
Finance ratio – interest coverage ratio				X	
Finance ratio – debt service coverage ratio				X	
Dividend – payment ratio				X	
Dividend – retention ratio				X	
Dividend – sustainable growth rate				X	
Cash Flow – interest cash cover ratio		X			
Cash flow – short term debt cover		X			
Performance ratio – sales growth	X				
Return on investment – return on assets		X			
Return on investment – return on equity		X			
Activity/turnover Ratio – Debtor days				X	
Activity/turnover ratio – creditor days			X		
Activity/turnover ratio – Working capital to sales	X				
Leverage ratio – fixed cost/variable cost			X		

Step (2) Analyse and interpret the outcomes of critical financial analysis

A borrower's business performance, or capability to repay the obligation, is related to its entire business, financial, liquidity risk, and total corporate risk. A borrower with better financial strength might be able to tolerate somehow higher risk in the above areas. The table below illustrates an example of relating borrowers' outcomes of critical financial analysis to borrowers' business risk, operation risk, and financial risk:

Outcomes of Critical Financial Analysis	**Risk Level Evaluation Based on Borrowers' Financial Strength**		
	Business Risk at Relatively High Level	**Operation Risk at Relatively High Level**	**Financial Risk at Relatively High Level**
High risk in business performance e.g., operating income e.g., interest payment e.g., net profit	↑	↑	↑

Step (3) Evaluate credit risks

The critical analysis of "exposure at risk," "default risk," "recovery rate," and "tenor" includes an examination of the borrower's track record, business performance, and collateral valuation. The table below illustrates an example of relating the outcomes of critical financial analysis on borrowers to the credit risks:

Outcomes of Critical Financial Analysis	Exposure at Risk	Default Risk	Recovery Rate	Tenor
Factors for consideration				
Relatively dissatisfactory track record e.g., repayment record		↑		
Relatively dissatisfactory business performance e.g., inconsistent business performance over years		↑		
Relatively dissatisfactory collateral valuations e.g., borrowers do not possess marketable assets as collaterals	↑		↓	

Step (4) Estimate the degree of risk involved in the loan

Loan costs are closely related to a series of factors that depends on the borrower's credit risk level. Therefore, RPs must carefully consider the loan pricing for quality negotiation with borrowers.

RPs also need to analyse whether the credit risk is proportional to the loan pricing given three different scenarios:

- Base Case
- Stress Case
- Default Case

The table below shows examples of relating credit risk to the costs of loan offers:

	Potential Impact on Cost of loan offer				
Credit Risk Type	**Funding Cost**	**Overhead Expenses**	**Admin Cost**	**Loan Loss Reserve**	**Capital Charges**
Relatively higher risk in exposure	↑			↑	↑
Relatively higher risk in default		↑		↑	
Relatively higher risk in recovery			↑		
Relatively higher risk with tenor	↑			↑	

(2) Estimate the degree of risk involved in base, stress and default scenarios

Stress testing and sensitivity analysis are practical analytical tools to embed estimation of business risk, financial risk, and total risks with an impact on future cash flow.

Other than base-case cash flow analysis, stress testing, sensitivity, and default analysis on cash flow help identify vulnerabilities of the cash flow.

Base case for cash flow analysis

To perform a cash-flow analysis of a base-case scenario, one may apply the NPV and IRR analysis to the cash flow forecast within the relevant time horizon. The table below shows some examples of the application of NPV and IRR analysis:

Relevant Time Horizon	NPV Analysis	IRR Analysis
Time horizon (1) Time horizon matches with the loan tenor/exposure **Time horizon (2)** The time horizon might be two to three years for a business with very high stability, such as a utility business. **Remark** Either (1) or (2), the cash flow projection on an ongoing basis is necessary	**Application** For a project with initial cash outflow **Objective** To ascertain if the present value of all the cash flow forecasts is more than the initial cash outflow. In other words, the project provides more than sufficient cash to meet the obligations	**Application** For a project with initial cash outflow **Objective** To ascertain whether the return on investment (initial cash outflow, plus the subsequent cash outflow if applicable) is satisfactory relative to the minimum requested by the bank

Stress case for cash flow analysis

The party submitting the pro-forma statements, in general, wishes to present a better than now business picture to engage better the investors/creditors. Therefore, adopt the prudence principle to build a stress scenario.

Macro-Economic Situations	Industry Situations	Specific Company Situations
Starting point The worst situations actually happened in the past serve as the base case. **Stress conditions** RPs should apply the bank's stress scenario for the cash flow assumptions. **Remark** Stress scenarios based on the past worst situation will be less controversial between the borrowers and the creditors.	**Starting point** The worst situations actually happened in the past serve as the base case. **Stress conditions** The creditor should consult an industry consultant for the stress conditions for cash flow forecast analysis. **Remark** Frontline marketing officers and Approvers need to continually scan the economic and industry environments to understand the cash flow generation capability better.	**Starting point** The worst situations actually happened in the past serve as the base case. **Stress conditions** The creditor should request from the management on the worst performance year to set up the stress conditions within the specific business. **Remark** The frontline marketing officer should review the worst year performance to confirm its validity for the stress testing.

Default case for cash flow analysis

There are no fixed rules on the default case conditions. However, RPs may refer to the historic default cases that happened to borrowers in the same sector/industry, suggesting the default point. The following table shows examples of possible default scenarios:

	Business Risk	**Operations Risk**	**Financing Risk**
Scenario (1)	RPs may evaluate business risk as acceptable with the following situations: - Industry cycle at stability - Macro-economic environment at stability	RPs may evaluate the operations risk as bad with the following situations: - Hyper inflation - Supply Chain interruption	RPs may evaluate the financing risk as bad with the following situations: - All debt facilities fully drawn - Debt service cost/ interest rate surges
Scenario (2)	RPs may evaluate business risk as bad with the following scenarios: - Industry cycle at decline - Macro-economic environment at downturn	RPs may evaluate the operation risk as acceptable with the following situations: - Inflation steady - Supply steady	RPs may evaluate the financial risk as bad with the following situations: - All debt facilities fully drawn - Debt service cost/ interest rate surges
Scenario (3)	RPs may evaluate business risk as bad with the following scenarios: - Industry cycle at decline - Macro-economic environment at downturn	RPs may evaluate business risk as bad with the following scenarios: - Hyper inflation - Supply Chain interruption	RPs may evaluate the financial risk as acceptable with the following situations: - Utilization of debt stable because shareholders inject new capital - Debt service cost/interest rate steady

Sensitivity scenarios

The analysis may also include a unique sensitivity analysis. The following list shows some of the potential sensitivity required.

- The critical patent could no longer protect the business from new entrants because of upcoming technology
- Essential senior staff retirement with extension

2.3.4.4 Recommendations on whether the current assessment methods satisfy the changing lending criteria of the banks

(1) Regular situation to structure credit proposal with sound credit granting process

A bank operates under a sound credit granting process and prepares comprehensive documentation on the justifications for consideration:

- The recommendation on the loan application should include whether the current assessment methods satisfy the changing lending criteria of the banks.
- The recommendation should contain justification on the revised assessment criteria and approaches for determination of the approval or rejection of the loan application and approved loan size.
- Where applicable, the recommendation should specify revised principles for justification of approval on the application which violates credit risk policies or general lending criteria.
- The recommendation, where applicable, should justify approval of an application violating credit risk policy or lending criteria.

(2) Sample credit structure proposal with T&C suggestions for approval

Each bank has its version of the qualified credit report. After a thorough qualitative and quantitative risk factors analysis, RPs could fulfill the following content list in a credit report.

- Background of the company
- Loan purpose and specifics (e.g., amount, tenor, duration)
- Capital structure
- General information section (e.g., management experience, senior teams, business models)
- Competitors Comparison (e.g., qualitative, and quantitative risk factors)
- Debt servicing history
- Financial statement summary
- Financial ration analysis (e.g., operations, financials)
- Critical financial analysis (e.g., income generation capability, financial strength, key business drivers)
- Cash budget analysis
- Budget and pro-forma analysis
- Cash flow analysis
- Stress test analysis
- Sensitivity analysis
- Explicit assumption list (e.g., economic outlook, industry, and business outlook)
- Other qualitative considerations (e.g., business relations)
- Risk assessment recommendation
- Risk rating recommendation
- Risk mitigant availability
- Product type alternatives and recommendation
- T&C recommendations
- Security and guarantees availability
- Recommendation on current assessment methods
- Recommendations on exceptions

<u>(3) Credit structure with current assessment methods under changing lending criteria</u>

<u>Note to trainers</u>

Trainers may consider embedding in assessment questions the three scenarios:
-Example of credit proposal with approval and reason
-Example of a credit proposal with a rejection decision and justification
-Example of a credit proposal with a rejection decision and subsequent appeal for approval

RPs should sensitize with all sizeable items with potential risks, which might result in an increased credit risk level of the loan. The RPs should also sensitize how the borrowers aggregate or breakdowns the reported items in the financial statements to minimize the visibility of specific items.

RPs should be aware of the changing lending criteria of the bank due to changes in the regulatory environment or the market competition. However, strict compliance with the credit guideline and asking for higher-level approval would always cover any uncertainty about the changing lending criteria.

RPs in the approval job functions carry out similar critical financial analyses to assess the borrowers' business risk, operations risk, and financial risk, as well as evaluate the capability of debt servicing and willingness to pay. However, because of cumulated experience on credit lessons learned and success cases are taken, it's more likely to exercise a better-quality judgment on the credit risk assessment.

<u>(4)Credit structure with recommended revised assessment criteria and approaches for determination of approval</u>

<u>Note to trainers</u>

Trainers may consider embedding in assessment questions the three scenarios:
-Example of credit proposal with approval and reason
-Example of a credit proposal with a rejection decision and justification
-Example of a credit proposal with a rejection decision and subsequent appeal for approval

<u>(5)Justification for approval on application violating credit risk policy or lending criteria</u>

CR-G-2 specified that "Requirements for all new credits or renewal of existing credits to undergo thorough credit appraisals before approval and for justification of any decisions violating credit risk policy criteria and identifying the persons authorized to approve such decisions.

2.3.4.5 Identify the client's purpose and objectives, develop repayment plan and financial options

Justification for approval on application violating credit risk policy or lending criteria

Note to trainers
Trainers have various options for guiding the learners to think about different situations regarding proposal approval:

Option (1) asking the Bank to provide relevant cases of the following examples:

- *credit proposal with approval and reason*
- *credit proposal with rejection decision and justification*
- *credit proposal with rejection decision and subsequent appeal for approval*

Option (2) extract from the learners' sharing of credit proposals in the "Best Case Handled" presentation session and have the learners share different circumstances and handling methods when the following situations happen:

- *with approval and reason*
- *with rejection decision and justification*
- *with rejection decision and subsequent appeal for approval*

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3 Module 3 - Content Notes

3.1 Submodule 1: Credit Facility Structure of Bank Products

Note to trainers

-Trainers can pick, change, and repackage the content sample below according to learners' need.

Introduction

Loan agreement

The core essence of a loan agreement is the act of borrowing and repaying with interest, along with setting terms, conditions, and acknowledging consequences for non-compliance. A comprehensive loan agreement offers both certainty and adaptability, ensuring borrowers have committed funds tailored to their business needs (adaptability) and a clear repayment timeline (certainty).

Credit Facility

A credit facility may be one component or aspect of the broader loan agreement. A loan agreement might include multiple credit facilities, such as both term loan and revolving credit, letter of credit, serves a different purpose and has its own terms and conditions.

3.1.1 Basics in bank products for identification of product-loan applicants' suitability

3.1.1.1 Bank product features for general and large enterprises

(1) Overview

Financial solutions for general and large enterprises typically focus on complex, large-scale financing and risk management strategies, while those for small and medium enterprises are more centred around flexible, accessible funding options and tailored risk assessments.

Note to trainers

(1) Please include financial solutions to SMEs, such as SME financing guarantee schemes, unsecured personal lending, and property lending to the directors. (2) Please obtain loan agreement and credit facilities information related to loans to small and medium enterprises, large corporates, and listed companies from live cases for class. The following table provides a sample content structure:

The table below shows a sample overview of bank products for general and large enterprises:

Solutions	**Conventional corporate finance**	**Structure Finance**			
		Project Finance	**E&P financing**	**Asset-based finance**	**Lease financing**
Purpose					
Examples	-Working capital	-Real estate -Infrastructure e.g., telecom e.g., social structure	-Oil & Gas -Mining	-Inventory -Receivables -Ships -Aircrafts -Railways	-Ships -Aircrafts
Bank Products					
Examples	-Revolving -Demand -Term	Tranche -A -B -C	Example Term loan Revolving loan Letter of Credit		-Operating -Financial
Entity					
-Special purpose vehicle (SPV)	-	✓		✓	✓
-SPV Sponsors[50] (Various sponsors -Financial -Industrial -Public -Contractor)	-	✓		✓	✓
Stakeholders					
-Contractors -Financial advisor	-	✓		✓	✓
Participants					
-Lead Bank -Arranger -Participating bank	-	✓		✓	✓
Risk assumed by					
-Single bank	✓	✓	-	✓	✓
-Two Banks (Club deals)	-	✓	-	-	-
-Three/more banks (Syndication loan consortium)	-	✓	✓	-	-
Document					
-For fund release -For maintenance	-	✓		✓	✓
Repayment Source A bank's primary consideration when approving credits should always be the borrower's financial strength and deb-servicing capacity. It is important that they do not rely solely on collateral or guarantees as the primary source of repayment or as a substitute for evaluating the borrower's creditworthiness.					
Main source	Corporation	SPV		Asset	Lease
Duration					
Short Term (<5 years)	✓	-	-	✓	✓
Long Term (>5 Years)	✓	✓	✓	-	✓

[50] Shareholders of the SPV

(2) Large Scale and consortium-based lending

The complex and large-scale financing needs of general and large enterprises make syndicated loans an ideal solution, as they offer substantial capital through a consortium of lenders, catering to their extensive and multifaceted financial requirements.

Note to trainers

Trainers may further elaborate loan financing arrangement according to the context tailored for the learners.

The table below provides a sample structure of syndicated loans:

<table>
<tr><th colspan="2">Syndicated loan</th></tr>
<tr><td>Purpose</td><td>Syndicated lending refers to the arrangements whereby multiple lenders advance funds jointly to one or more borrowers (e.g., SPV within one borrowing group). For examples:
- Collective funding: participating banks form a consortium to fund structured credit facilities with one or multiple leading banks to manage them
- Alignment: participating banks align contributions under a unified loan agreement and framework to realize the following advantages:
• substantial financing volumes
• extended tenures
• diversified lender participation
• accessible financing criteria</td></tr>
<tr><td>Examples</td><td>- Real estate project
- Infrastructure project
- E&P of oil and gas</td></tr>
<tr><td rowspan="3">Sponsor
SPV</td><td>- Lead Bank Selection Process:
• Invitation: The borrower initiates the process by identifying and inviting a prospective lead bank with a mandate letter and a preliminary overview of the loan project.
• Project Assessment: The invited bank evaluates the project's viability. A positive assessment culminates in issuing a conditional commitment letter to the borrower.
• Strategic Dialogue: Both parties collaboratively discuss the loan's foundational framework, including its structure, methods, and associated conditions.
• Board Authorization: Upon concurring with the terms, the board of directors dispenses a letter of authorization. This letter facilitates the lead bank to structure the loan and assemble a consortium legally.</td></tr>
<tr><td>- Documentation Phase:
• Letter of intent: A comprehensive document outlining the borrower's legal, financial, and operational landscape, ensuring the lead bank transparently presents pertinent facts to potential consortium members.
• Credit facility: A cornerstone document delineating principal loan terms and conditions as a precursor for subsequent loan agreement drafts.
• The Loan agreement, guarantees, and collaterals: The borrower and the bank agree on pivotal loan covenants, encapsulating requisite approvals, permits, and adherence to term sheet preconditions.</td></tr>
<tr><td>- Consortium Commitment Phase: Participating banks articulate their commitment through letters outlining their loan share and any specific participation terms.</td></tr>
</table>

	• Share Allocation**:** The lead bank allocates loan shares among banks, meticulously managing risk and acceding to acceptable preconditions.
	- **Contractual Negotiations:** Representing the consortium, the lead bank negotiates the loan's final terms with the borrower.
	- **Operational Enforcement & Management:** Post syndicated loan agreement ratification, the correspondent bank is entrusted with daily management, which encompasses: • Loan disbursements and borrower withdrawals • Issuance of withdrawal notifications • Interest rate affirmations and loan tenure extensions • Establishment of a representative to collect principal, interest, service fees, and their subsequent disbursement to consortium members • Periodic scrutiny of guarantee stipulations and borrower's adherence to the loan agreement • Distribution of regular updates to consortium members • Coordination of consortium meetings, a mandate either shouldered by the lead bank or the correspondent bank
Stakeholders Participants	- **Naming systems** There are different naming systems of the participating banks, e.g., • Underwriters • Sub-underwriters • Arrangers • Agents (facility and security) • Legal counsel • Participating banks
	- **Lead Bank/Underwriter:** • Underwrite: provide all or part of the syndicated loan if any portion remains unsold, subject to satisfactory documentation • Sub-underwriting: underwrite up to the limit of their sub-underwriting. - **Arranger**: • Have the borrower's mandate to arrange credit facilities on mutually agreed terms between the arranger and the borrower. • Perform the roles of o With the borrowers: structure and negotiate the terms of the transactions o With the lenders: ✓ Prepare the information memorandum or package ✓ Form the underwriting group, if appliable ✓ Develop a syndication strategy, including the strategy for soliciting participants and securing their commitment ✓ Coordinate the drafting of documentation by legal professionals ✓ Handle signing of the facility and any publicity - **Agent** • Obtain and perfect collateral • Appointed to hold or administer collateral on behalf of the lenders • Verify compliance with pre-conditions by the borrowers and issue confirmation to the lenders • Vet any drawdown notices from the borrower and inform the lenders • Coordinate payments by the lenders and reroute the funds to the borrower

	• Distribute repayments by the borrower to the lenders • Advise the lenders of any default, actual or potential, by the borrower of which it becomes aware as regards repayments and other terms of the loan agreement. **Participating Banks** - • A syndicate member not engaged in the above roles • Each member may employ its own legal and financial advisors
Risk	- **Lender's Risk management** • Collective wisdom and experience: enables risk mitigation processes (e.g., protective covenants) in the agreement. • Independent analysis: each member should perform an independent analysis of credit risk concerning the credit quality of the borrower and the suitability of the deal in relation to its own risk appetite, despite the collective wisdom mentioned. • Several liability: the liability clause indicates "several" for the consortium, reducing risk by the sharing. • Secondary market: the lenders manage their risk exposures through various means such as secondary loan sales and credit derivatives. • Verify compliance: the arranger (facility and security) verifies compliance with pre-conditions by the borrower (and guarantor, if appropriate) based on guidance given by legal counsel and issuing confirmation thereof to the lenders • Withdraw notice: the agent (facility and security) vets any drawdown notices from the borrower • Borrower's appointment of auditor: whose appointment must be satisfactory to them • Controls over syndicated lending: ✓ Policies and procedures ✓ Credit appraisal, review, and monitoring ✓ Documentation ✓ Monitoring compliance with covenants
	- **Borrower's risk management is through the right o have** • lenders making loans • lenders mitigating costs • getting rid of a bank in a group of lenders • obtaining documentation from lenders • e.g., invoice/statement of amount of interest, fees, reimbursable expenses due • designating additional borrowers • curing breaches • e.g., Clauses "so long as the credit agreement contains the requirement that the default be continuing to constitute an event of default". • confidentiality • loan buyback • amending, extending, and refinancing facilities
	- **Problem loan management** • The arranger advises the lenders of any default, actual or potential, by the borrower by which it becomes aware of repayments and compliance with covenants and other terms of the loan agreement.

	• React Responsibly: Individual banks in the consortium should react responsibly in problem loans so that the interests of lenders, borrowers, and other parties are adequately safeguarded.
Document	- Document should also include • Loan application • Information memorandum • Financial statements • Business plan • Due diligence documents • Loan agreement • Syndication agreement • Security documents • Legal Opinions • Credit facility • Compliance certificates • Environmental and regulatory compliance documents: • Insurance policies • Legal and regulatory filings • Tax documents • Executed loan documents • Know your customer (KYC) and anti-money laundering (AML) documentation - Documentation should cover provisions dealing with issues such as • Tax gross ups • Increased costs • Illegality
Maintenance	- Authentication of the documents to reveal significant deviations from loan contractual term and assumptions at the time of loan approval, e.g., • Construction progress and budget reports • Periodic financial statements
Repayment Source	Depends on loan purpose: - **Corporate Income** (Corporate loan) - **SPV** (e.g., E&P, Asset-based, leasehold-based)
Duration	Actual duration based upon actual cases. The followings are examples: **E&P** - **financing**: long term (>5 years) - **Asset-based financing**: short term (<5 years)

(3) Project and specialized financing

Note to trainers

Trainers may further elaborate financing arrangement according to the context tailored for the learners

Introduction: Conventional bank products and structured lending solutions

The table below gives an overview comparing conventional bank products with structured lending solutions for general and large enterprises:

Conventional bank products	Structured lending solutions
Plain and straightforward loans, also known as Vanilla Loans, can either have a bullet or amortizing structure and do not entail any complexity or necessitate specific legal, financial, or engineering considerations. The sole and straightforward risk for the bank in such loans pertains to the creditworthiness of the company to which it has extended the funds.	A structured facility is defined by the level of control that the financier has over the flow of goods and money. Structured finance refers to transactions in which lenders provide funding to a specialized company, commonly referred to as an SPV (Special Purpose Vehicle), established exclusively for the purpose of financing the acquisition of either financial or physical assets, or a group of such assets. Repayment of the loan is directly tied to the performance of the underlying assets, relying on the income generated by the SPV. Lenders assume the risk associated with these assets and do not have any recourse against the equity holders within the SPV.

Project Financing

The table below provides a concise sample structure of content notes on project finance:

Project Finance	
Purpose	Funding the construction of a specific asset, such as infrastructure, through a Special Purpose Vehicle (SPV) utilizing an amalgamation of debt and equity
Examples	- Real estate project finance - Infrastructure
Examples Common Loan Types	- **Tranche A: Term Loan** • Fully amortizing loan o Amortized down to zero over the life of a project o Maturity based on the revenue stream of SPV o Loan draw-down progressively during the construction period. • Balloon payment loan o Tenor spanning 7 to 10 years o Culminating in a balloon payment. o Comprehensive settlement of the residual sum post the 7 to 10-year period. o Need refinancing the loan on or before its maturity. o Failure to meet refinance/pay the obligation results in a default
	- **Tranche B: Revolving** • Contingency available for SPV should there be any project oversight • Typical interest rate for this tranche being higher than that of the primary tranche • Having tenure of 7 to 10 years culminating in balloon payment

<table>
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- Being non-obligatory repayment nature after the tenure, should the SPV opt to retain the loan
- Return-risk commensuration achieved with a typically notable increase in the interest rate, hence the profit margin
- The sponsor being conventionally restricted from receiving dividends post the initial tenure
- The entirety of the project's cash flows channeled towards loan repayment

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- **Tranche C: Letter of credit, e.g., export credit**

Note to trainers
Trainers should tailor the content materials tailored for the context of the learners, e.g., for borrowers with export orientation, provide supplement to Tranche C

The table below shows a sample for reference:

<table><tr><td>

-Export Credit Agencies (ECAs)
ECAs are pivotal in infrastructure financing, serving as trusted liquidity sources under governmental oversight. These agencies primarily aim to enhance liquidity for purchasers and bolster exports. Their mandate revolves around endorsing the export of equipment and services from their respective nations. Prominent ECAs globally include Canada's EDC, China's Sinosure, BPI France, Germany's Euler Hermes, Italy's SACE, the United Kingdom Export Finance, and the US Ex-Im Bank, among others. They typically provide financing through two primary mechanisms:

- Direct loans to importers for procuring services or goods from the ECA's home country.
- Buyer credits are extended to importers to acquire services or commodities from the ECA's native country.

-Incentive to Banks
From a Basel regulatory perspective, loans that receive backing from ECAs overseen by governments of countries with an OECD rating of 0 or 1 bear no weightage. Practically, a loan safeguarded by an ECA affiliated with a highly industrialized government results in zero Risk-Weighted Assets (RWAs)—the nil impact on the regulatory capital, offering a significant incentive for banks to participate.

</td></tr></table>

</td></tr>
<tr><td>Sponsor</td><td>

- **Sponsor:** Sponsors are the shareholders of the SPV. They provide equity to the project and are the first to suffer financially if the project fails. They have significant liabilities upon default since lenders have recourse to the sponsor.

</td></tr>
<tr><td></td><td>

- **Financial Sponsors:** Typically encompassing investor groups, their primary orientation is maximizing the return on investment (ROI). They do not perform any industrial tasks related to the projects they invest in.

</td></tr>
</table>

	- **Industrial Sponsors:** Typically engaging in substantive business operations beyond investing in infrastructure endeavors. Their involvement in projects typically aligns and synergizes with their core business functions. Examples of their project roles: • Overseeing the operation and maintenance of the project post-construction, the construction phase of the project • Designing the project with detailed and pertinent specifications • Conducting comprehensive assessments to ensure sufficient resources Acquiring and securing land tailored for the project
	- **Contractor Sponsors:** They infuse subordinated or unsecured capital, often combined with equity contributions. Their involvement is instrumental in business entities' initiation and operational facets.
	- **Public Sponsors:** They typically consist of governmental entities operating at various administrative levels.
	- **Financial Advisor:** They typically perform the following roles • Provides expertise, market knowledge, and additional resources to optimize the sponsor's offer. • Model and structure the transaction • Ensure a smooth execution of the transaction
SPV	- **Special purpose vehicle (SPV)** SPV means special purpose vehicle, which is a non-operating entity established for the sole purpose of raising capital.
	- **Initiation process** • Feasibility Analysis: the sponsor assesses whether project finance aligns- with the most appropriate financing mechanism for the transaction. • Knowledge Acquisition: the sponsor delves into and comprehends the nuances of project finance, ensuring they are well-versed with its features and intricacies. • Business Plan Formulation: the sponsor meticulously translates the project's vision, approach, and tactics into a robust and persuasive business plan to secure the confidence and financial backing of equity stakeholders and project financiers.
	- **Debt-Capital Structure** The inherent stability in cash flows, coupled with the tangible asset collateral, renders infrastructure projects particularly favorable to financiers. Consequently, the capital structure for infrastructure financing often demonstrates a pronounced leaning towards debt. According to research[51], the debt components are: - 50-75% senior debt, - 0-10% junior debt, and - 20-40% equity ***Note to trainers*** *Trainers may include materials related to debts of SPV of specific industries.*

[51] 201704_Infrastructure_financing_an_overview.pdf (schroders.com)

<table>
<tr><td></td><td>The table below shows a sample of attributes of debt of SPVs with the purpose to raise capital for infrastructure construction:

- Liquidity e.g., public, private
- Nature e.g., greenfield, brownfield
- Sectors e.g., transport, power, utilities, telecom, social
- Geography e.g., west Europe, south Europe, CEE, UK, OCED, Emerging
- Business: e.g., availability, contracted, concession, regulated, merchant
- Rating: >A-, BBB/BBB+, BBB-, BB+/BB, NR
- Maturity: 20Y+, 10Y-20Y, 7Y-15Y, Other
- Currency: EUR, GBP, USD, AUD, Other
- Rate: Fixed, floating</td></tr>
<tr><td rowspan="3">Stakeholders</td><td>- Single companies
For other projects, sponsors prioritize simplifying their engagement by limiting their interactions with multiple counterparties. The E&P contract allows the project company to offload the execution to a single, specialized contractor.</td></tr>
<tr><td>- Consortium of companies
For projects characterized by large-scale or intricate requirements, sponsors typically rally a consortium of companies to handle the E&P Company's responsibilities collaboratively. With this arrangement (engineering, procurement, and construction), the contract stipulates that all entities within the consortium bear joint and several liabilities about the SPV.</td></tr>
<tr><td>- Other stakeholders
• Local governments often pull together industrial stakeholders to facilitate viable projects and financing solutions. Here is an example of Hong Kong: IFFO.
• “IFFO[52] is a platform established in July 2016 by the Hong Kong Monetary Authority (HKMA) to facilitate infrastructure investments and their financing.”
• By establishing IFFO, the HKMA can play a valuable role as a catalyst in this development with its mandate to promote Hong Kong as an international financial center.
• Another advantage is the HKMA’s strong relationship with major players in infrastructure investment and their financing, whose engagement and support are crucial to achieving success.</td></tr>
<tr><td>Participants</td><td>- Single bank
- Club deal
- Consortium</td></tr>
</table>

[52] Hong Kong Monetary Authority - IFFO Partners (hkma.gov.hk)

Risk	- **Principle to determine debt amount** Net operating cash flow must be higher than the debt repayment obligations of the SPV (principal and interest). - **Risk exposure to participants** • Credit risk • Construction risk: the sum of all the risks that can delay or prevent the construction of a project or significantly push up its total cost) • Resources risk: depend on the presence of natural resources, e.g., oil, gas) • market risk, interest rate risk, liquidity risk, operational risk, legal risk, reputation risk and strategic risk
	- **Risk exposure to sponsors** • refinancing risk • syndication risk • legal risk • force majeure risk • political risk • economic risk • technical risk • credit risk • Unexpected capital or operating cost increases • Uncertainty of meeting anticipated program milestones at the borrower's projects • Risk associated with investment in publicly listed companies, such as the borrower • Risk associated with general economic conditions
	- **Exposure to Corporates** In the consultation of BASEL III implementation on SACR, HKMA proposed that, for unrated specialized lending exposures, the risk-weights applicable are 100% for project finance exposures during operational phase, and 130% for project finance exposures during pre-operational phase. The industry suggested to implement the preferential risk-weight of 80% for high quality project finance in operational phase.
	- **Problem loan - react Responsibly** Individual banks in the consortium should react responsibly[53] in the situation of problem loans so that the interests of lenders borrowers and other parties are properly safeguarded.
	- **Other risks** ***<u>Note to trainers</u>*** *Please provide training materials on specific risks according to the specific purpose of the financial solutions:*

[53] Useful reference is provided in the guidelines jointly issued by the Hong Kong Association of Banks and the HKMA titled "Hong Kong Approach to Corporate Difficulties"

	The table below contains a sample on risk of specific industries: **Construction Risk (e.g., real estate, infrastructure)** -Risk to secure all essential building permits: SPV must secure necessary permits before committing any financial support to a project. -Risk on technical feasibility and adherence to budget: engage independent technical advisors to pinpoint the project's technical feasibility, adhering to the budget stipulated by the sponsors. -Risk on subcontracting: engage esteemed construction firms to adopt a consortium-led approach where multiple expert firms collaboratively take charge rather than a singular contractor. **Resource Risk (e.g., oil and gas extraction, renewable energy)** -Uncertainty in the estimation, economic viability, recoverability, and proceeding of mineral resources: engage specialized engineers and independent geologists tasked with gauging the potential availability and accessibility of resources. -Risk on inadequate data analysis: mandate an additional independent review for enhanced due diligence; employ a base case scenario, factoring in a defined certainty level over the resource reserve, and conduct risk assessments based on potential downside **Other Risks** -Risk of government regulations, policies, or legislation change -Risk of implementation: timely progress report review -Risk of meeting additional funding requirement: flexibility to invite new participating bank -Risk of price change: hedging with financial instruments
	- **Allocation of risks** • Project financing structure comprises of participants possessing niche proficiencies tailored to specific project risks. • The outcomes are: ○ a reduction in overall co-financing costs, ○ eradication of inefficiencies impacting consumers and investors ○ more projects in the pipeline
Document	**Sample list of documents:** Each bank has its own requirement on documentation. The following is a list of documents for reference: • Loan agreement • Security documents • Business plan and project overview • Financial statements • Projections and budgets • Environment impact assessment reports • Legal opinions • Due diligence reports • Compliance and reporting documents • Insurance policies • Market studies and research • Regulatory approvals and filings • Contracts and agreements • Tax documents • Know your customer (KYC) • Anti-money laundering (AML) documents

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Project documentation
Loan drawdown and disbursement records
Correspondence and communication
Event and covenant tracking
Ongoing reporting (e.g., regular financial reporting, compliance certificates)

</td></tr>
<tr><td>Maintenance</td><td>
- Authentication during documentation review to reveal significant deviations from loan contractual term and assumptions at the time of loan approval, e.g.,

Construction progress and budget reports
Periodic financial statements

</td></tr>
<tr><td rowspan="3">Repayment Source</td><td>
- Due diligence
Project finance requires detailed due diligence before investment decision. Lenders must meticulously calibrate their loan amounts based on the assets' projected revenue-generating capability.
</td></tr>
<tr><td>
- Operating cash flow
Identification of operating cash flow of the SPV is the first step towards development of its financial model.
</td></tr>
<tr><td>
- Computation formula
<table>
<tr><td></td><td>Net operating cash flow</td></tr>
<tr><td>+</td><td>Revenue</td></tr>
<tr><td>-</td><td>Cost of raw materials</td></tr>
<tr><td>-</td><td>Operating and maintenance costs</td></tr>
<tr><td>-</td><td>Insurance</td></tr>
<tr><td>-</td><td>Levies and taxes</td></tr>
<tr><td>=</td><td>Gross operating cashflow</td></tr>
<tr><td>-</td><td>Increase/decrease in working capital requirement</td></tr>
<tr><td>=</td><td>Net operating cash flow</td></tr>
</table>
</td></tr>
<tr><td>Duration</td><td>
Trend after 2008 Global Financial Crisis
- Basel III Requirement
For a transaction of a specific size and credit rating, Risk-Weighted Assets (RWAs) and capital utilization tend to escalate considerably as the loans’ tenure increases. Consequently, many banks find extending loans beyond 20 to 25 years challenging. This has resulted in a diminished inclination towards long-term project financing.
- Competition
Established investment institutions are increasingly facing challenges from entities that, historically, acted merely as limited partners within their investment portfolios. A prevailing sentiment among these entities is questioning the prudence of remitting fees to an investment establishment upon procuring a position in a Special Purpose Vehicle (SPV). This viewpoint is grounded in the belief that the SPV, which functions based on a pre-set direction, chiefly draws upon the acumen of industrial sponsors for the intricacies of project operations. Noteworthy competitors encompass:
- Insurance corporations
- Pension fund entities
- Sovereign wealth entities
- Diversification into Infrastructure-like Assets:
</td></tr>
</table>

	Post-financial crisis, with the liquidity surge in the infrastructure domain, anticipated yields and Internal Rate of Returns (IRRs) for investors have been under duress. Addressing this dynamic, certain financial sponsor have broadened the infrastructure definition, venturing into assets less pursued by contemporaries. Such assets, including wind or solar farms, highways, airports, and ports, typically exhibit: - Enduring tangible asset nature - Public utility attributes - Operations within near-monopolistic markets.
Example Cases	- **Australia** Resources mining/Green and Sustainability linked loan[54] - **Hong Kong** • The Kai Tak Multi-Purpose Sport Complex[55] [56] • The Hong Kong Integrated Waste Management Facilities[57] [58] • MTR new extensions[59]

Exploration and production (E&P) financing

Note to trainers

Trainers may further elaborate financing arrangement according to the context tailored for the learners. The content notes below shows a sample content structure, using oil E&P for reference.

The table below provides a concise sample structure of content notes on E&P:

E&P Loan	
Risk	- **E&P stage with risk**
	• **Exploration stage** ○ Focused on identifying and assessing potential hydrocarbon reserves beneath the Earth's surface. ○ Involves geological and geophysical survey, seismic data analysis, and drilling of exploration wells to confirm the presence of oil or natural gas reservoirs.
	• **Exploration stage** ○ Involves creating a wellbore/borehole deep into the Earth's subsurface to access and extract hydrocarbons. ○ Involves the use of specialized drilling rigs and equipment to penetrate through various layers of rock and sediment to reach the reservoir.
	• **Completion** ○ Involves the activities performed to prepare a drill well for production. ○ Involves the installation of well casing and tubing, implementation of downhole equipment to optimize the flow of oil or gas from the reservoir to the surface.
	• **Production**

[54] US$130M Project Financing for Sal de Vida signed - Bloomberg
[55] ha1109cb2-156-5-e.pdf (legco.gov.hk)
[56] p15-03e.pdf (legco.gov.hk)
[57] ea20230130cb1-42-4-e.pdf (legco.gov.hk)
[58] Microsoft Word - LegCo paper Eng 18 Feb 2011 Final -clean
[59] tlb202303 20230301-e.pdf (legco.gov.hk)

    - Involves the extraction of hydrocarbons from the reservoir and brought to the surface for processing and distribution.
    - It involves the operations to pump, separate and pressure control to maximize the recovery of oil or gas.

- **Transportation**
    - Involves the movement of extracted hydrocarbons from the production site to different destinations, e.g., refineries, processing plants, distribution points
    - Involves the transportation with pipeline, tanker, marine vessels before reaching markets.

- E&P technology with risk

- **Exploration technology**
    - Seismic imaging: to create images of subsurface rock formation, helping geologists identify potential reservoir
    - Remote sensing: to produce satellite imagery and aerial surveys aid in identifying geological features and potential drilling locations
    - Magnetic and gravity surveys: to detect variations in Earth's magnetic and gravitational fields to indicate the presence of hydrocarbon deposits.
    - Directional drilling and horizontal drilling: to access reservoirs in challenging geological conditions.

- **Drilling technology**
    - Drilling rigs: equipped with advanced automated control systems, and safety features to efficiently drill deep wells.
    - Drilling fluids: Equipped with parts to drill mud, to lubricate the drill bit, control the pressures, remove cuttings and fragments during drilling
    - Downhole tools: examples are equipment to capture real-time data on subsurface conditions e.g., pressure, temperature

- **Completion technology**
    - Different technologies used for different types of completion, such as open-hole completion, sand exclusion completion, permanent completion, drain hole completion
    - Wellbore casing: reinforced steel casing inserted into the wellbore to isolate and protect the surrounding rock formations
    - Perforating tools: tools to create holes in the casing to allow hydrocarbons to flow into the wellbore
    - Downhole pumps: electric submersible pumps or other lift systems to bring hydrocarbons to the surface
    - Safety valves: surface and downhole safety valves enduring controlled flow and prevent well blowouts

- **Production technology**
    - Production facilities: equipped for separators, heaters, dehydration units to process and separate oil, gas and water
    - Subsurface pumps: equipped for lifting oil to the surface, especially in mature or low-pressure reservoirs
    - Supervisory control and data acquisition systems: equipped to monitor and control production processes remotely

	• **Transportation technology**
	  ○ Pipeline; extensive network of pipelines for the efficient and safe transportation of oil and gas over long distances
	  ○ Tanker ships: large tankers transport crude oil and LNG across oceans
	  ○ Truck Transport: Tanker trucks move oil and gas for oil and gas delivery

Document	Each bank has its own requirement on the documentation. The following Sample list of documentations for E&P financing is for reference only:
	- **Business Plan and Project Overview:**
	  • Detailed description of the E&P project, including its location, objectives, and scope.
	  • Overview of the company's business plan, including long-term goals and strategies.
	- **Financial Information:**
	  • Financial statements (balance sheet, income statement, cash flow statement) for the company.
	  • Projected financial data, including revenue projections, capital expenditures, and operating costs.
	  • Historical financial performance of the company, if applicable.
	- **Reserve and Resource Reports:**
	  • Reports on proven, probable, and possible reserves or resources in the project area, prepared by qualified reservoir engineers and geologists
	  • Estimates of recoverable hydrocarbons and reserve life
	Technical Data:
	  • Geological and geophysical data, including seismic surveys and well-log data
	  • Reservoir characterization reports, including porosity, permeability, and reservoir pressure data
	- **Well drilling and completion plans:**
	  • Impact statements (EIS) for the project
	- **Documentation of regulatory permits and approvals:**
	  • Related to drilling and production operations
	- **Compliance plans and reports:**
	  • Related to health, safety, and environmental regulations
	- **Market Analysis:**
	  • Market research and analysis of oil and gas prices, supply-demand dynamics, and market trends
	  • Marketing and sales strategies for the produced hydrocarbons
	- **Contractual Agreements:**
	  • Details of existing contracts or agreements with suppliers, contractors, and offtakes
	  • Agreements related to joint ventures, partnerships, or other financing arrangements
	- **Risk Assessment and Mitigation Plans:**
	  • Risk analysis identifies potential project risks and strategies for mitigating them
	  • Insurance coverage and policies in place to manage operational risks
	- **Legal Documents:**
	  • Corporate documents, including articles of incorporation, bylaws, and ownership structure

	- • Agreements related to land leases, surface rights, and access to drilling locations **Project Schedule and Milestones:** • Project timeline outlining key milestones, such as drilling commencement and production start dates - **Management Team:** • Résumés and biographies of key management personnel and technical experts involved in the project • Market and Financial Assumptions: - • Assumptions underlying financial projections, including commodity price forecasts, production rates, and operating costs **Collateral and Security Documentation:** • Any collateral or security agreements, such as mortgages or liens on project assets, if applicable.
Example cases	A borrower's business models can lead to business needs on E&P financing: - **ExxonMobil Corporation**[60]: one of the largest publicly traded oil and gas companies globally and has secured financing for numerous E&P projects worldwide - **Royal Dutch Shell**[61]: one of the major multinational energy company that has financed various E&P ventures, including deepwater drilling and unconventional oil and gas production - **Chevron Corporation**[62] [63]: one of the major energy companies involved in E&P projects in various regions, from conventional oilfields to shale oil (unconventional oil and gas production) - **BP Plc**[64] [65]: Involved in offshore drilling projects and has obtained E&P financing for activities in regions including but not limited to Gulf of Mexico and North Sea - **TotalEnergies**[66]: A French multinational energy with E&P projects around the world, including in Africa, the Middle East, and South America. **ConocoPhillips**[67]: Involved in D&P financing in both conventional and unconventional resources and has secured financing - **Eni S.p.A.**[68] [69]: An Italian multinational oil and gas company with E&P activities in regions including Africa, the Mediterranean, and the Arctic **CNOOC** Limited[70] [71]: China National Offshore Oil Corporation is a Chinese state-owned company that has E&P projects offshore in South China Sea. **Petrobras**: Petroleo Brasileiro S.A.[72] [73]is a Brazilian state-controlled energy company with extensive offshore E&P projects

[60] Exxon Mobil Corp - Company Profile and News - Bloomberg Markets
[61] Shell PLC - Company Profile and News - Bloomberg Markets
[62] Chevron Corp - Company Profile and News - Bloomberg Markets
[63] Case example: Chevron Announces Major Oil Discovery in Deepwater Gulf of Mexico - Bloomberg
[64] BP PLC - Company Profile and News - Bloomberg Markets
[65] Case Example: BP Considers Building Two UK Wind Farms Without Any Subsidies - Bloomberg
[66] TotalEnergies SE - Company Profile and News - Bloomberg Markets
[67] ConocoPhillips Co - Company Profile and News - Bloomberg Markets
[68] Eni SpA - Company Profile and News - Bloomberg Markets
[69] Case Example: Eni's Africa Biofuel Feedstock Plan to Cost €700 Million - Bloomberg
[70] CNOOC Ltd - Company Profile and News - Bloomberg Markets
[71] Case Example: CNOOC Limited Announces Egina Field Commenced Production - Bloomberg
[72] Petroleo Brasileiro SA - Company Profile and News - Bloomberg Markets
[73] E&P Case Example: Brazil's Petrobras Gets Permit to Drill at Key Offshore Area - Bloomberg

(4) Asset-specific lending

Note to trainers

Trainers may further elaborate Asset-based & leased-based financing according to the context of the RP. The following table shows a sample content structure of asset-based financing.

***Assets** in this context are physical, movable and expensive assets. Asset finance techniques are mainly employed to finance acquisition of aircraft, ships or trains. Sometimes, there are asset finance for helicopters, containers or cranes, but relatively rare.*

***Asset financing** refers to the use of a company's balance sheet assets, including short-term investments, inventory and accounts receivable, to borrow money. The company borrowing the funds must provide the lender with a security interest in the assets.*

***Both "on" balance sheet and "off" balance sheet items** should be scrutinized to reveal specifics which affects the assessment of the borrower's financial strength.*

Case example: WeWork[74] in its 2019 pre-IPO disclosure, revealed one of the industry's largest lease commitments, notable for a company founded less than a decade earlier. These commitments, originally excluded from the balance sheet and only noted in footnotes due to prevailing accounting practices, shred light on the impact of change in accounting rules (IFRS16[75]). This rule change mandated the inclusion of lease commitments as balance sheet liabilities, along with a corresponding asset for the right to use leased property. The accounting shift significantly altered WeWork's financial presentation, adding substantial liabilities to its balance sheet.

Case example: Many companies make use of supplier finance obligations to free up cash so that they can invest in their operations, buy back stock, or issue dividends. The obligations[76] did not show in the balance sheet until 2023. As of May 2023, about 80 companies in S&P 500 index reported at least USD64.1 billion worth of obligations in a type of borrowing that lets them postpone payments to suppliers. Supplier finance (also known as reverse factoring or supply chain finance) sees companies making arrangements with lenders to pay supplier bills quickly. Suppliers accept a slightly lower payment in exchange for getting paid as soon as possible. Companies then pay the lender back anywhere from 30 days to as much as a year later. Before the rule changes, these figures are not easily visible.

[74] WeWork IPO: Lease Obligations and an Ugly Balance Sheet - Bloomberg
[75] Say Hello to $3 Trillion in Forgotten Debt - Bloomberg
[76] New Rules Show $64 Billion Hidden Debt at Large US Companies - Bloomberg

Overview of asset-based vs lease-based financing

The table below provides a concise sample structure overview of asset-specific lending outlining difference between asset-based financing and lease-based financing:

Structure	Asset-based financing	Lease-based financing	
	Legal charge on the asset	Finance lease	Operating lease
Suitable for (example)	Asset users that want to own the asset and use it over the long term. Example: -ship financing	Businesses looking to use an asset without owning it outright. Example: -equipment leasing	Companies needing assets for short-term use without ownership. Example: - aircraft leasing
Lender/financier (Example)	Bank	Bank or leasing company	Bank or leasing company
Lessee	Gains ownership after final payment	Has option to acquire ownership at lease end	Use the asset for lease term, without ownership
Lessor	Not applicable	SPV or leasing company	SPV or leasing company
		Often funded by banks	Often funded by banks
Option to buy	Ownership transferred after loan is paid off	Option to buy at the end of the lease, often at a reduced price	Typically, no option to buy
Risk assumed by the lessor	-credit risk of borrowers -asset valuation risk	-residual risk	-operating risk -valuation risk of the asset
Risk assumed by the lessee	N/A	-Operating risk	N/A
Operating expense (Example)	Lessee is responsible for maintenance, taxes, insurance	Lessee is responsible for maintenance, taxes, insurance	Lessor is responsible for maintenance, taxes, insurance
		Lessee has control over the asset, similar to an owner	
Repayment	By installments to bank	Lease payments to lessor	Lease payments to lessor
Constraints (Example)	Upfront investment: typically a down-payment	-Less initial expenditure -Finance terms often match asset life	-Flexibility in terms (return, purchase, extend the lease) -Often more expensive over short term
Examples of industries	Construction Agriculture and farming Shipping	Airline	Airline

Asset-based financing

The table below provides a concise sample structure of content notes on asset-based financing:

<table>
<tr><th colspan="2">Asset-based financing</th></tr>
<tr><td>Purpose</td><td>Asset-based financing is a business financing strategy that uses a company's assets (physical, movable, expensive), such as accounts receivable, inventory, or machinery, as collateral to secure a loan or line of credit. It is a form of secured lending where the value of the assets, instead of the credit worthiness of the borrower, determines the amount of financing a company can access. Businesses use this type of financing to meet their working capital needs, fund growth initiatives, or address short-term cash flow challenges. Asset-based financing provides businesses with a flexible source of capital that can help them manage cash flow, invest in growth opportunities, and navigate financial challenges while leveraging their tangible assets as collateral to secure financing.</td></tr>
<tr><td>Products</td><td>- Bank products
• Asset-specific loan (Legal charge on the asset)</td></tr>
<tr><td></td><td>- Industries
• automotive,
• business services,
• consumer products,
• distribution & wholesale,
• e-commerce & retail,
• food & beverage,
• manufacturing,
• transportation & logistics (airline, shipping, railways)</td></tr>
<tr><td></td><td>- Assets, examples
• Aircraft, Ships, Trains</td></tr>
<tr><td></td><td>- Legal Charge
• Definition
o A borrower takes out a loan to finance an asset
o In exchange for this loan, the borrower gives a mortgage on the assets
o Mortgage is a right to take possession of the assets if the client does not repay the loan
• Features
o The loan is a corporate loan with an additional collateral on the asset
o Repayments are due even if the asset is not used by the client
o The repayment of the loan is not directly linked to the profitability or performance of the asset taken independently
• Problem loan handling
• Upon default, the lender that has a mortgage on the asset can repossess the asset and sell it
• Loan to value (LTV)
• According to terms
• Duration
• According to terms</td></tr>
<tr><td>Sponsor
SPV</td><td>Key initiation steps
- Identification of Assets: The first step in asset-based financing is identifying and assessing the company's eligible assets as collateral. Typical assets</td></tr>
</table>

	include accounts receivable, inventory, equipment, real estate, and sometimes intellectual property. - **Asset Valuation:** Once an entity identifies the assets, an independent third-party appraiser prepares an assessment report to determine their current market value or a predetermined percentage of their values for collateral. - **Credit Limit Determination:** The lender then determines the maximum credit limit or loan amount that the business can access based on the appraised value of the assets. Lenders typically provide financing up to a certain percentage (e.g., 70-80%) of the asset's appraised value. - **Loan Agreement:** The lender drafts an agreement specifying the terms and conditions of the financing arrangement. The terms include interest rates, repayment terms, reporting requirements, covenants, and any fees associated with the loan. - **Collateral Monitoring:** The lender actively monitors the collateral, often requiring the borrower to provide regular updates on the value and condition of the assets. This mechanism helps ensure the collateral remains sufficient to cover the outstanding loan balance. - **Borrowing Process:** When the business needs funds, it can draw from the approved credit line by pledging eligible assets as collateral. The amount borrowed depends on the company's working capital needs or specific financing requirements. - **Repayment:** Repayment terms can vary but typically include regular interest payments and, in some cases, principal repayments. The borrower must adhere to the repayment schedule outlined in the loan agreement. **Renewal and Review:** Asset-based financing arrangements are often subject to periodic reviews by the lender to reassess the value of the collateral and adjust credit limits accordingly. The financing facility may be renewed or modified based on the company's financial performance.
Documentation for risk management	The following is a sample list of documents which must be reviewed and authenticated to ensure that the bank has adequate, enforceable, and manageable collateral in place to mitigate credit risks effectively in asset-based financing: - **Valuation documents**: to support the current market value of the asset, ensuring the asset value is readily determinable, verifiable, and marketable with an existing secondary market for disposal. - **Legal and ownership title**: Proof of legal ownership and enforceability, free from prior claims or equal ranking claims by other parties. Control and custody documents: evidence of the bank's right to repossess and control the asset, particularly in the case of movable assets. - **Expertise and management system** summary: documentation demonstrating the bank's expertise and systems to manage the specific asset being used as collateral. - **Loan-to-value ratio compliance document**: to indicate the bank's adherence to the specific maximum loan-to-value ratios for the type of asset being collateralized. - I**nsurance coverage document: to i**ndicate the bank as the beneficiary. - **Regular valuation report:** documents to ensure the asset value remains in line with market conditions and the bank's requirements. - **Concentration risk document:** To indicate that the bank is in compliance with its policy on concentration risk concerning collateral types

	- **Legal compliance and safe custody** document: to indicate the bank's compliance with relevant laws and regulations, along with safe custody and access controls for the collaterals. - **Document on additional collateral:** in the case where value depreciation or deterioration in the borrower's debt-servicing ability - **Document on management information**: to monitor the concentration risks and stress-testing outcomes.
Maintenance	- Authentication of the documents to reveal significant deviations from loan contractual term and assumptions at the time of loan approval, e.g., • Construction progress and budget reports • Periodic financial statements
Example cases	Companies light on hard assets but with strong revenue stream Roark to Borrow $5 Billion in Structured Market for Subway Investment - Bloomberg Banks with quality assets Citigroup Leads $260 Million Financing for Hong Kong Lending Platform WeLab - Bloomberg

Lease-based financing

Note to trainers

Trainers may further elaborate Asset-based & leased-based financing according to the context tailored for the learners.

The table below provides a concise sample overview structure of lease-based lending:

Asset-based financing	
Purpose	Lease-based financing provides enterprises with alternative funding by leasing assets rather than purchasing them outright. It allows businesses to use essential assets like vehicles, machinery, or real estate without the upfront capital expenditure. The focus is on the usability and revenue-generating potential of the leased asset rather than its ownership, making it a viable option for enterprises seeking to preserve cashflow, reduce maintenance cost and avoid obsolescence risks.
Products	- Types of leases • Finance lease: long-term lease that transfer ownership or contains a purchase option at the end of the lease term. • Operating lease: short-term leases where the lessor retains ownership and bears the depreciation risk.
	- Industries • Transportation • Manufacturing • Retail • Technology
	- Assets • Vehicles • Industrial equipment • IT hardware • Commercial real estate
Product	- Legal charge is not typically applicable as the focus is on leasing, not securing a loan against assets.

Sponsor SPV	In some lease structure, particularly in large-scale or specialized leasing (like aircraft or ships), a SPV may be used to hold the leased asset and isolate financial risk
Key initiation steps	- **Identification of lease assets**: selecting assets suitable for leasing based on business needs. - **Lease agreement:** negotiating terms, including duration, payments, and responsibilities (maintenance, insurance and others) - **Credit assessment:** evaluating the lessee's creditworthiness - **Asset valuation:** determine the value of the asset for lease purpose - **Lease execution:** finalize the lease agreement for commencement - **Asset monitoring**: ongoing monitoring of the asset's condition and the lessee's compliance with the lease terms.
Risk	**Exposure to Corporates** - In the consultation of BASEL III implementation on SACR, HKMA proposed that, for unrated specialized lending exposures, the risk-weights applicable are 100% for project finance exposures during operational phase, and 130% for project finance exposures during pre-operational phase. The industry suggested to implement the preferential risk-weight of 80% for high quality project finance in operational phase. The industry also requested the definition of specialized lending be widened to accommodate aircraft and ships finance under operating leases given their operational features. - Ultimately possible flexibility is being considered for aircraft and ships finance under operating leases to be classified as specialized lending (e.g. Banks to demonstrate that the repayment of the obligation is the income generated by these specific assets instead of a specific asset either in legal form or in economic processs) provided the spirit of the relevant Basel standards are not violated. The HKMA will consult the industry on any further guidance in due course.
Documentation	The following is a sample list of documents: - **Lease agreement:** outlining terms, responsibilities and conditions - **Credit assessment report**: evaluating the lessee's ability to meet lease payment - **Asset valuation report:** regularly updating on the asset's market value - **Insurance documents**: ensuring adequate coverage of the leased assets - **Maintenance records**: documenting the upkeep of the assets - **Compliance documents:** ensuring adherence to regulatory requirements related to leasing.

Maintenance	- Authentication of the documents to reveal significant deviations from loan contractual term and assumptions at the time of loan approval, e.g.,
	  • Construction progress and budget reports
	  • Periodic financial statements

Example Cases	Bank's subsidiary leasing air fleet to aviation companies CDB Aviation Leases Fleet of Six Boeing and Airbus Aircraft to Hainan Airlines - Bloomberg Aviation leasing company leasing to aviation companies AerCap to Lease Three New Boeing 787-9 Aircraft and 25 New Boeing MAX-8 Aircraft and Extend Leases on Six Airbus A330-200 - Bloomberg

Case: Bank products for aircraft
Airline loan This standard loan for aircraft financing is extended directly to airlines, offering complete corporate responsibility and secured with a mortgage (or charge) over the aircraft. These loans have terms ranging from three to 15 years and are typically structured to amortize. The Loan-to Value (LTV) ratios vary between 50% and 85%, including pre-and post-COVID situation, and payment currency per contractual terms. For airlines with revenue not in the contractual payment currency have a currency mismatch risk which might be mitigate with a basket of currencies.
Operating Lease The lease format is essentially a rental contract where the airline (lessee) pays for using the aircraft for a set period. The regular lease payments cover economic depreciation, interest, and returns to the lessor, who retains the ownership of the aircraft. Additional rent often covers maintenance cost, while the operator bears all other operational expenses. Typically lease terms range from 3 - 12 years. Upon lease expiry, the lessee must ensure the aircraft meets specified maintenance standards for subsequent leasing.
Finance Lease In finance lease arrangement, the airline pays a substantial initial rental, with a lease term longer than operating leases. The lessee is granted a fixed-price purchase option at the end of the term. Economically similar to a loan with a non-recourse balloon payment, the key legal difference is that the creditor retains legal title until the purchase option is exercised, as opposed to holding a mortgage (or charge) over the aircraft.
Non-recourse Investor Loan This loan is made to the aircraft's owner, who is not the operator. The owner leases the aircraft to an airline, and the lender's security includes both a mortgage (or charge) over the aircraft and an assignment of the lease. Payments typically flow directly from the lessee to the lender. In cases where the borrower is a SPV, the final balloon payment becomes effectively limited recourse, with the bank relying on the aircraft's value for the final settlement.
Pooled Investor Loan The investor or SPV owns multiple aircraft leased to one or several airlines. This diversification across different aircraft and lessees lowers the bank's risk. The probability of simultaneous aircraft runouts and default by all obligors is minimal. Additional risk reduction is achieved through cross-collateralization of the leased aircraft.
Syndicated Investor Loan This loan involves multiple banks. In the event of default or at loan maturity, the proceeds from the collateral are distributed among the banks in proportion to their loan share, up to their claim amount.
Tranche Investor Loan Upon default, a senior lender is prioritized for repayment from the proceeds until their exposure is fully covered. A junior or subordinated lender receives repayment only after the senior lender is fully satisfied. Since the risk is higher for junior position, the junior lender requests a higher return.

The table below list some examples of documents required for aircraft financing:

-Application form with details of the borrower and the purpose of the loan -Business and financial statements -Business plan -Aircraft specification and valuation -Proof of insurance -Title and registration documents -Appraisal and inspections documents -Lease agreements, if applicable -Environmental and regulatory compliance -Credit history reports -Collateral documents -Legal opinion e.g., enforceability of the financing agreement and compliance with law -Guarantees or additional security -Risk assessment reports e.g., market risk, operational risk, credit risk -Repayment plan

(5) Trade loan and working capital based lending

Note to trainers

Trainers may further elaborate the following products according to the context tailored for the learners.

Trade loan

Trade and import loans, including those for buyer and seller, serve as financial tools to bridge funding gaps in trade cycles. A bank release funds based on the documents outlined in lending agreements, which verify the fulfilment of commercial contracts, like on-schedule goods shipment.

The table below outline a sample of key stages in a typical trade cycle, corresponding structured loans where applicable, and the documents required for the loans:

End of day	Trade cycle	Potential structured loan	Document to fulfill structure loan requirement	Risk Assessment
0	Goods shipped by the supplier	N/A	-Bill of lading: consigned to the order of the bank -Air Waybill: the goods consigned to the order of the bank	Detail check list for risk assessment[77]
20	Supplier paid (e.g., 20-day credit from date of shipment)	N/A	-Proof of payment -Supplier's invoice	
40	Goods arrive at warehouse (awaiting delivery to the end-buyer)	Goods in transit trade loan	-Warehouse receipt -Insurance document	
	Or, Goods delivered end-buyer invoiced (payable 90 days from invoice date)	Warehouse trade loan	-Storage agreements -Delivery confirmation	
100	No specific event	N/A	N/A	
190	No specific event	N/A	N/A	
	Or, invoice due date (e.g., day 195 from Day 20 for trade loan duration)	Receivable trade loan	-Accounts receivable ledger -Confirmed invoices	
195	Proceeds received	N/A	-Payment confirmation -Bank statement	

[77] Refer to optional reading: Trade and receivable finance, Stephen A. Jones, Palgrave macmillan, 2018

Working capital loan

Note to trainers

-Trainers may further elaborate the following products according to the context tailored for the learners.

The table below outline a sample illustration of working capital loan:

Comparison	**Asset-based financing**	**Lease-based finance**	
		Finance lease	**Operating lease**
Product Example			
Product Examples	Loans against collaterals, which can be used to support working capital. Examples are: - **Real estate** - **Inventory** - **Equipment & machinery** • Bar and pub • Restaurant and takeaway • Café, bakery, coffee shop • Buses, coaches, cards, vans, trucks • Garage • Laundry and dry cleaning equipment • Office and IT equipment • Warehouse equipment • Refrigeration and air conditioning - **Letters of credit,** providing support to working capital for trade - **Accounts receivable** financing, to support working capital	Long-term lease at the end of which the lessee usually has the option to purchase asset at a residual value	Shorter-term lease where the term is usually shorter than the asset's useful life

3.1.1.2 Overview of products' unique features affecting product-client suitability

Note to trainers

Trainers are to develop thinking framework to guide the learners to consider from both perspectives of the corporate borrowers and the banks regarding consideration of all the unique product features on their own suitability assessment.

Suitability assessment is a risk-based process that involves the matching of corporate borrower's funding needs with the banks' credit strategies. The following table provides a comparative analysis of the unique features of structured finance and general banking facilities, highlighting their influence on the suitability assessment from the perspectives of both corporate borrowers and banks, with a focus on project finance as an illustrative example:

Matrix Showing How Unique Bank Product Features Tied to Product Client-Product Suitability				
Features of project finance	**Relevance to Corporate Borrower in consideration of product suitability**		**Impact on banks in consideration of product suitability**	
	Structured finance	**General banking facilities**	**Structured finance**	**General banking facilities**
Purpose (e.g. funding construction through SPV)	Ideal for large-scale, asset-specific projects requiring significant capital.	More suitable if the corporation has a broader focus beyond project-specific finance.	In-depth assessment of project viability and SPV structure.	More applicable to the broader nature of the financial needs.
Product loan types (e.g. Tranche A, B, C)	More flexible depends on specific project needs and cash flow structure and financial needs.	More suitable for funding of day-to-day working capitals without much restriction on loan purposes.	Mainly assess total risk and return of specific project with differentiated pricing strategy on each tranche	Focus on more standardized loan products rather than highly tailored needs.
Sponsor types (e.g. financial, industrial)	Type of sponsor affects project credibility and financial stability.	More focus on borrower's overall credit worthiness.	More focus on evaluating sponsor's financial strength and experience in similar projects.	More emphasis on borrower's credit history and financial health.
Stakeholders (e.g. consortium)	Involvement of multiple stakeholders can enhance project credibility.	Easier risk assessment and management.	More on assessing the capacity and reliability of each stakeholder in the consortium.	More focus on reliability and capacity of the borrower's customers
Risks (e.g., construction, resources risk)	Detailed assessment of project-specific risks.	More focus on the borrower's business such as overall financial health and market stability.	More comprehensive risk analysis for each aspect of the project.	Broader risk evaluation based on borrower's industry and market conditions
Repayment source (e.g., operating cash flow)	Alignment of repayment with project cash flow.	More flexibility in overall repayment capacity.	More scrutiny of project's revenue generation and cash flow forecasts.	Evaluation more based on borrower's overall financial stability.
Duration (e.g. long-term for infrastructure projects)	Suitability for medium to long-term financing needs	More in alignment with balance sheet management and liquidity strategy of overall business	More focus on consideration of medium to long-term financial commitments and project life.	More consideration of the alignment of the purpose of the funding subject. e.g. A/R, Inventory, office

3.1.2 Financial solution customization with view of adequate protection of bank's interest

Note to trainers

The support materials below focus on structured loans which usually customize to corporate's funding needs.

3.1.2.1 Understanding bank's credit strategies to protect bank's interest

Every borrower has different wants and needs when finding the right loan structure. Despite bank's customization according to the borrower's wants and needs, the learners must have a thorough understanding of the [link] bank's credit strategies.

3.1.2.2 Evaluating credit worthiness of the sponsors of structured finance

Note to trainers

Trainers should tailor content for specific industries according to the context of the learners. The content notes below refers to the aircraft financing.

The table below shows examples of key drivers of credit worthiness, other than credit history, in assessing credit worthiness of sponsors of airline industry, according to credit rating agency.[78]

Evaluating Sponsors' Credit Worthiness Factors Affecting the Strength of Business Key Drivers				
Business key drivers	**High**	**High/Medium**	**Medium**	**Medium/Low**
Industry dynamics and competitive environment	1-Industry cyclicality 2-Competition/ commoditization 3-Pricing inflexibility	1- Ease of entry	1-Product quality/ pressure 2-business model instability	1-Product cycle/ obsolescence 2-Disintermediation substitution 3-Demographic trends
Growth and profitability	4-Profit margin pressure/ outlook 5-Earnings volatility		3-Growth outlook	
Operating consideration and cost	6-Cost rigidity/ inflexibility 7-Operating leverage 8-Energy cost sensitivity 9-Labor costs 10-Labor inflexibility/ unrest 11-Event-risk sensitivity	2-Pension costs/contingents 3-Environmental impact/costs 4-Risk management 5-Asset quality/ plant upkeep and age	4-Supplier concentration 5-Financial volatility/ sensitivity 6-Interest rate sensitivity	4-Technological risk/ change 5-Marketing costs 6-Fashion/ fad/ design sensitivity 7-Research and development costs 8-Raw material cost sensitivity 9-Customer concentration
Capital and financing characteristics	12-Capital intensity 13-Borrowing requirements 14-Regulation/ deregulation/ patents	6-Government microeconomic and social policy	7-Litigiousness/ legal risk	

[78] mt20120322152358.pdf (maalot.co.il)

3.1.2.3 Assessing risks of the applications

Overview of assessment models

The table below illustrates the potential methods, which could be used parallelly as reference for each other, to estimate the propensity of the borrower to default.

Assessment Methods That Can Be Used Parallelly to Assess Risks of Applications				
Methods to estimate default risk	**Expert system**	**Credit scoring**	**Structural**	**Reduced-form model**
Description	This method relies on specialized knowledge and subjective analysis of key variables. Key indicators of a company's credit health are evaluated and synthesized into a comprehensive credit score or rating.	By examining historical data of other borrowers and adjusting the significance (weight) of different factors based on actual default cases, using a variety of regression methods, the likelihood of default can be quantified.	The risk of a borrower failing to meet obligations is inferred from changes in their equity's market value and volatility, providing insights into the chance of the borrower's assets falling below a specific default threshold.	The danger of default is reflected in the market value of the borrower's publicly traded debt or credit derivatives. The yield on these instruments is decomposed into a risk-free component and an additional risk premium. Need to make assumptions about recovery at default as well as the market price of risk.
Constraints	There is a lack of uniformity and objectivity.	Requires a substantial amount of historical data.	Applicable if the borrower has publicly traded securities.	

Assessing risk of applications

Business strategies can be validated and ascertained from various perspectives. The following list from illustrates a sample of considerations:

-Evaluating risk factors affecting tailoring of terms and conditions
-Assessing aligned needs of assets and debt-equity structures
-Identify financing means for structuring deals

(1) Evaluating risk factors affecting tailoring of terms and conditions

Business strategies

The table below illustrates examples of business factors which should align with one another for a sound business strategy:

Business Factors Which Should Align with One Other for A Sound Business Strategies				
Life stage	**Business model**	**Management quality**	**Equity/debt leverage**	**Sensitivity to five forces**
- Start up - Growth - Rapid growth - Plateau - Decline	- Key business drivers	- Management team analysis - Via analysis with e.g., SWOT, Canvas	-Percentage of debt to equity -Interest servicing capability	- Suppliers power (e.g., reflected in negotiation power) - Customers power (e.g., reflected in price sensitivity) - Product substitute - Competitions (e.g., reflected in market share) - government - operations

Reference to previous modules [link] Business strategy

Business earnings

For businesses of relatively stable sector, the business earning is important for the risk analysis of the application. For instance, the business operating distribution system of electricity.

Repayment history

In-house or third party rating is based on a series of historical data and disclosure by the management. To give an additional aspect of the risk of the application, the bank will analysis the past payment history to ascertain the borrower's willingness to fulfil the terms and conditions.

Business outlooks

The table below shows examples of factors of consideration in assessing business outlooks:

Factors of Consideration in Assessing of Business Outlooks				
Financial Analysis	**Site visit**	**Business model**	**Business cycle**	**Industry cycle**
- Outcomes of analysis - Sources and causes of outcomes of - financial analysis Identify key - business drivers Interpretation of financial analysis	- Outcomes of site visit - Authenticatio n of financial analysis - Interpretation of the outcomes of site visits	- Uniqueness of the corporate borrower's business model	- State of business cycle - Business outlook - External factors with different levels of impact on key business drivers	- State of industry cycle - Intelligence from industry information - Relativity to industry norm, or competitors

Note to trainers

Trainers should tailor content for specific industries according to the context of the learners. The content notes below refers to the aircraft financing.

The case below exemplifies discussions of the industry cycle complexity and attractiveness of aircraft security for structured financing:

Case (Part 1) - Dilemma
Aircraft Financing: Balancing Business Cycle Complexities and Asset Security A. Financing the airline industry is a challenging task because of the highly uncertain and complex dynamics in business outlook. *-High aircraft cost* Aircrafts range from USD50 million to USD250 million, requiring significant capital outlay. *-Long-term investment with shorter refinancing term* Long term investment recovery contrasted with shorter, for example, 7-year refinancing period. *-Substantial fixed cost* High fixed costs lead to a challenging profitability threshold. *-Cyclical nature of the industry* Demand variability due to the discretionary nature of travel impacts financial stability. B. On the flip side, however, banks seek to offer aircraft financing because of factors such as -The high certainty of the secured assets based on the following: • *Standardized assets* Commercial aircraft, predominantly from Airbus or Boeing, face limited competition and substitution. • *Longevity of assets* Aircrafts have a lifespan of 25 – 30 years, with resale value in parts and scrap. • *Robust secondary market* Specialized aircraft valuators provide previse assessments in a well-structured secondary market, utilizing detailed technical records of each aircraft. -The cash flow • Cashflow projection based on current scenarios • Sensitivity analysis based on various scenarios • Stress testing

The table below shows an example about the potential industry outlook:

Case (Part 2) – Recovery
A-Situations during pandemic -95% fall in traffic across -54% of the world's global population subject to lockdown measures -Reduction in aircraft production e.g. A320s, A330s, A350s, 787s, 777s, 737 B-Post-pandemic recovery However, the recovery 2022 to 2024 was also fast. As of January 2023, air transport and seat capacity and passenger totals globally reached almost 80% of pre-pandemic level. Pre-pandemic levels expected to be exceeded in 2024.[79]

The table below shows another example of the potential business outlook:

Case (Part 3) – Supply
A-Stockpile Boeing Cuts Annual Delivery Target for 737 Jet on Quality Lapses - Bloomberg B-Supply Issues Melrose Says Supply Issues Holding Back Even Stronger Growth - Bloomberg

[79] Recent Trends in Aviation Finance and Leasing: Post-Pandemic Guidance For Operating Lessors and Financiers | White & Case LLP (whitecase.com)

Projected business performance (earnings and others)

Note to trainers

Trainers should tailor content for specific industries according to the context of the learners. The content notes below refer to the aircraft financing.

Ratio and competitive analysis are essential methods to reveal projections of particular areas requiring attention or deep diving in data extraction. The table below shows some of the key performance ratio of airline companies:

Example – Performance Ratio of Airline Companies			
Ratios	**Definition**	**Formula**	**Norm**
Quick ratio	Measures an airline's short-term liquidity and cash flow. It indicates whether a company can cover all its short-term debt obligations with its liquid assets	Liquid assets/Current assets	Higher values are better, with any value below one considered disadvantageous
Return on assets (ROA)	Indicates the per dollar profits a company earns on its assets. It's a measure of profitability, especially relevant for airlines given their reliance on planes as primary assets.	Net income/Total Assets	Even a relatively low ROA can represent significant profits due to the substantial assets owned by airline companies
Debt-to-capitalization ratio	Evaluates the debt position and overall financial soundness of companies with significant capital expenditures, like those in the airline industry.	Total debt/total available capital	Ratio lower than one are preferred as they indicate a lower level of financial risk.
Available seat miles (ASM) Or Available seat kilometers (ASK)	Measures the total number of passenger carrying capacity available for an airlines.	Number of available seats on each flight X number of miles flown.	This metric is used more as a comparative tool to evaluate operational scale and capacity utilization rather than having a normative value
Cost per Available Seat Mile (CASM)	Represent the cost to operate each seat mile, including fuel, maintenance, and labor cost. It is crucial for understanding the cost efficiency of an airline.	Total Operating Costs/Available Seat Miles	Lower values are better as they indicate higher cost efficiency.
Break-even Load Factor	The percentage of seats that must be filled on an aircraft for an airline to breakeven on that flight. It factors in both the costs and revenues associated with airline operations.	Fixed costs/(Ticket Price per Passenger x Available Seat Miles)	Lower values are preferable, indicating that fewer seats need to be filled to breakeven.
Revenue per Available Seat Mile (RASM)	The metric calculates the revenue generated per available seat mile and is a key indicator of an airlines' revenue efficiency.	Total Revenue/Available Seat Miels	Higher values are desirable, signifying better revenue generation per seat mile.

Passenger Load Factor	Percentage of seating capacity utilized.	Number of seats filled /Total available seats	Higher values are desirable.
Revenue Passenger Kilometers (RPJ)	Fare-paying passenger traffic	Number of fare-paying passengers X distance flown	Used to assess passenger demand and revenue
Return-to-Normal (RTN[80])	Current seat availability vs. pre-pandemic period.	Current ASK/ASK in 2019	Catching up with the 2019 indicators says about the recovery level post-pandemic

3.1.2.4 Assessing aligned needs of assets and debt equity structure

(1) Needs in asset investment and operating assets

Investment assets and operating assets

The table below shows examples of asset investment and operating assets:

<table>
<tr><th></th><th>Asset investment</th><th>Operating assets</th></tr>
<tr><td>Definition</td><td>An asset used for long-term investments.

The table below shows some classifications of asset investment:
<table>
<tr><td>Liquid</td><td>Fixed</td></tr>
<tr><td>Marketable stocks</td><td>Investment property</td></tr>
</table></td><td>An asset which is required for day-to-day operations to sustain itself.

The table below shows some classification of operating assets:
<table>
<tr><td>Tangible assets</td><td>Intangible assets</td></tr>
<tr><td>Property, plant and equipment</td><td rowspan="3">Recognized intangible assets e.g. Intellectual property</td></tr>
<tr><td>Inventory</td></tr>
<tr><td>Accounts receivable</td></tr>
</table>
…</td></tr>
</table>

Reference to previous modules[link]financial analysis

Operating Assets Values

Note to trainers

Trainers should tailor content for specific industries according to the context of the learners. The following discussion is constructed around aircraft financing to exemplify the assessment of values of operating assets.

[80] Airlines Are Watching One Number: the Return-to-Normal Metric - Bloomberg

There are many different value definitions of an aircraft. The table below indicates some of them:

Example – Basis of Valuation for an Aircraft				
Theoretical value	**Current market value**	**Base value**	**Distressed sale value**	**Maintenance value**
The net present value of future cash flow adjusted for factors like -aircraft's life cycle -market conditions -changing operational efficiencies over time	The potential to earn a fair return over the medium term adjusted for factors like -aircraft type -leasing rates -global economic environment	The book value less depreciation adjusted for factors like -market penetration -switching costs -aircraft's volatility relative to market changes	This value is considered in highly illiquid markets where heavy discounts are applied and adjusted for factors like -urgency of the sale -market liquidity -availability of financing options play a crucial role in determining the distressed sale value	Maintenance status is a significant determinant of an aircraft's market value, considering its impact on safety, operational efficiency, and regulatory compliance

The table below shows the potential concerns from the bank's perspective:

Assessing Aligned Needs of Asset Investment **Factors Causing Bank's Potential Concerns**				
Income-generating capacity	**Cash flow adequacy**	**Debt-service coverage ratio**	**Asset liquidity and distressed values**	**Maintenance and upkeep costs**
It involves assessing the potential revenue which an aircraft can generate over its useful life with considerations of factors, e.g., -lease rates -occupancy rates -operational efficiency	Its emphasis on the aircraft ability to generate enough cash flow in the current market environment to cover loan or lease payments, maintenance, and other operational costs.	It measures the cash flow available to pay current debt obligations, indicating the borrower's ability to produce enough income to cover the loan payments.	This involves assessment of the value of an asset that can be liquidated in a distressed market.	It involves looking at the cost of keeping the aircraft in a condition that ensures continuous income generation and compliance with safety and regulatory standards

(2)Adequacy in debt/equity structure

The table below shows the leverage ratios to indicate the level of debt incurred by a borrower against several accounts in its balance sheet, income statement, or cash flow statement. These ratios provide an indication of how the borrower's assets and business operations are financed (using debt or equity).

Ratios	**Formula**	**Interpretation**
Debt-to-asset ratio	Total debt/total assets	-The ratio indicates what proportion of a company's assets is financed through debt. -A higher ratio suggests that a larger portion of the company's assets are financed by debt, which can imply financial risk
Debt-to-equity ratio	Total debt/total equity	-The ratio measures the relative proportion of shareholders' equity and debt used to finance a company's assets. -A higher ratio suggests that the company has been aggressive in financing its growth with debt.
Debt-to-capital ratio	Today debt/(Total debt + Total equity)	-This ratio provides insight into the company's financial structure. It indicates the percentage o-f a company's capital structure that is funded by debt. -A lower ratio is generally preferred as it indicates a lower risk due to less reliance on debt.
Debt-to-EBITA ratio	Today debt/earnings before interest taxes deprecation & amortization	-This ratio measures a company's ability to pay off its incurred debt. -A lower ratio is better, suggesting that the company can clear its debt quicker, assuming constant EBITDA.
Asset-to-Equity ratio	Total assets/total equity	-This ration indicates the amount of assets that are financed by equity. A higher ratio implies that a company has more assets for each unit of equity, which can be a sign of financial stability, but also could imply higher leverage.

3.1.2.5 Identifying financing means for structuring deals

(1)Analyse and balance client's asset-liability portfolio

The table below shows examples of identifying financial means for structuring deals:

Means of financing	**Conventional lending**	**Asset-back financing**
Focus on	Analysis of strength and stability of cash flow analysis	Unlocking values of the borrowers' assets such as: -Accounts receivable -Real estate
Analysis	Analyse financial health and strength using financial ratios	Analyse the value of the business assets which are used as collaterals to secure a loan. Examples are -Accounts receivable -Inventory -Machinery and equipment -Real estate

Authentication	Undergo field examinations to determine the level and quality of its financial and physical assets.	Undergo field examinations to determine the level and quality of its financial and physical assets.
Pros and cons	Pros -Audited balance sheet is relatively easy to be made available Cons -When a company faces a drop in revenue, the faltering cash flow could mean it fails to meet its covenants. A bank could reduce credit availability, increase interest rate or take other measures to protect against bank losses	Pros -With loans backed by the assets, the borrower eases the worries of a lender -The borrower need only to maintain a minimum level of liquidity to avoid being subject to a financial covenant.
Candidate industry	All industries	Asset-rich companies, such as -Manufacturers of trucks -Distributors which stock up in advance of peak seasons -Retailers of significant inventories

Note to trainers

Trainers should reminder the learners the impact to the borrower's asset-liability portfolio should be monitored to sustain adequate debt-equity structure.

The table below shows the potential shenanigans with debts of a borrowers:

Case
Content: Highly leveraged firms' shifting from equity to debt financing is not just optimizing a firm's cost of capital, but also have profound implications for the firm's behaviour and investor outcomes. Source: Debt Is Trickier Than Equity – Bloomberg

3.1.3 Credit facility structure

3.1.3.1 Customizing financial package options – Terms and conditions for agreement and developing proposal

Having studied the product feature suitability for the borrower, the bank's credit strategies, the credit worthiness and the risk of the application, the bank identifies the financial means for structuring deals. The borrowers then consider the packing options as per features of the financing means, including but not limited to the options of the terms and conditions.

(1)Generic terms and conditions

The sample below shows a typical credit facility letter covering basics terms and conditions, while the footnotes which follows illustrates the typical arrangement of financing for airline industry.

Date: [Date]
[Recipient Name]
[Recipient Company]
[Recipient Address]
Dear [Recipient Name],
Subject: Credit Facility Offer
We are pleased to extend to [Recipient Company] (“Borrower”) a credit facility offered under the following terms and conditions:

(4) Facility (Note 1)

Type: [Specify type – e.g., Term Loan, Revolving Credit, Asset-Based Loan]
Purpose: [Clearly state the purpose of the loan, ensuring it aligns with structured finance objectives]
Amount: [Specify the total credit amount]

(5) Term (Note 2)

Effective Date: [Start date of the loan]
Maturity Date: [The end date of the loan]

(6) Interest and Fees (Note 3)

Interest Rate: [Detail the interest rate, whether fixed or variable and any applicable benchmarks]
Fees: [Outline origination fees, processing fees, and any other applicable charges]

(7) Repayment (Note 4)

Schedule: [Detail the repayment schedule, frequency of payments, and any grace periods]
Prepayment: [Terms regarding early repayment, if applicable]

(8) Security and Collateral (Note 5)

Collateral: [Describe the collateral or security for the loan]
Valuation: [Terms for valuation and periodic revaluation of collateral]

6. Cross-border exposure (Note 6)

Limits: [Overall limits and sub-limits]
Methods: [Measurement of country risk and report]
Collateral and Guarantees: [Types or, criteria for acceptance]

(9) Intercompany debts (Note 7)

Debt limit: [Details on debt purpose, maximum amount subsidiary can create, incur, assume]
Restrictions: [Details on debt incurrence conditions, such as within defined financial ratios]
Subordination: [Details, if applicable, that the debt of the borrower to the subsidiaries must be subordinated to the claims of the lenders]

(10) Covenants (Note 8)

Affirmative Covenants: [List of actions the borrower must undertake]
Negative Covenants: [Restrictions imposed on the borrower]
Financial Covenants: [Specify financial ratios or other metrics the borrower must maintain]

(11) Default and Remedies (Note 9)

Events of Default: [Define situations that would constitute a default]
Remedies: [Actions the lender may take in the event of default]

10. Governing Law (Note 10)

[Specify the governing Law and jurisdiction]

(12) Miscellaneous

Amendments: [Terms under which this agreement can be amended]
Serving notices: [Procedures for communication between parties]

12.Acceptance

Offer remains valid until [Expiration Date].
Accepted and Agreed [Client]

The footnotes below indicate examples of tailoring terms and conditions for aircraft financing.

Example – Tailoring Terms and Conditions for an Aircraft Financing

Note 1 – Loan Type

Examples of loan types
-Loan
-Operating lease
-Finance lease
-Non-recourse investor loan
-Pooled investor loan
-Syndicated investor loan
-Trenched investor loan

Note 2 – Loan Maturity

Examples of loan durations
-Longest financing term of 20 years
-Older aircraft financing terms of 10 – 20 years
-Variation example: 20-year amortization on a five-year balloon payment purchase

Note 3 – Factors to consider for terms and conditions – for airline financing

Examples of factors affecting the interest rates[81]
-Loan types e.g. term loan, credit lines, others
-Loan duration
-Loan amount
-Lead bank
-Bank's participating interest
-Credit rating e.g. S&P rating, Fitch rating, Moody, others
-Business strategy e.g. cost cutting, growth plan
Example of interest and fee structure
-Interest of LIBOR + 100 bp plus 9 bp ticking fee while the borrower does not draw the money
Examples of reported interest rate
Aviation Finance – The Cost of Capital – KPMG Ireland
Aircraft financing and leasing outlook Q2 2023: Key takeaways from the latest Ascend by Cirium webinar – Cirium
2023 Aviation Industry Review & Outlook — Report | PwC Ireland

Note 4 – Repayment

Example	Pre-COVID	Post-COVID
Portion to be amortized over the term of the loan	As low as 50%	Increased as much as 80%
Bank's monitoring	Banks ensure that the estimated value of the aircraft remans higher than the outstanding loan value	
	Banks ensure that the outstanding loan value decreases more rapidly than the aircraft's depreciation rate.	

...

[81] Boeing Shops $10 Billion Loan at Price Similar to Older Debt - Bloomberg

Note 5 – Security and collaterals

Examples of Collateral Considerations

When evaluating aircraft as collateral for loans, banks should consider the risk that the aircraft's value might drop below the remaining loan value if the borrower defaults. It's insufficient to rely only on appraisal values for this risk assessment. These values needed to be tested under scenarios of distressed sales, which may be necessary to recoup the owed amount. To reduce the potential for losses in cases of default, banks should consider limiting their financing to newer, more fuel-efficient aircraft models, as these may present a lower risk profile.

Note 6 – Cross-border exposure[82]

The following risks may either be grouped conceptually as cross-border risk:

-Country risk includes sovereign, transfer and contagion risk

-Sovereign risk denotes a foreign government's ability and intent to pay back its foreign currency debts

-Transfer risk refers to the risk of a borrower being unable to get foreign currency to pay off internal debt

-Contagion risk occurs when problems in one country cause credit downgrades of squeezes in others

-Currency risk happens when a borrower's local currency assets fail to dover foreign currency debts

-Indirect country risk is the risk that a local borrower's repayment ability is compromised by negative changes in foreign currency where it has significant operations or interest

-Macroeconomic risk involves the risk or a borrower suffering from high interest rates imposed by its government's efforts to protect its currency.

Example:

In China, a "cross-border financing" loan explicitly deals with credits involving cross-border risk. This financing category is designed to manage the risks associated with lending and borrowing across national borders. It includes various financial instruments such as cross-border loans, trade financing, and other forms of external borrowing. These loans are often subject to regulatory oversight by Chinese authorities, such as the People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE), to manage risks related to foreign exchange and ensure compliance with international financial standards. The regulations and guidelines for these loans are designed to mitigate risks like currency fluctuations, political instability, and differences in legal systems, which are intrinsic to cross-border financial activities.

Note 7

Large and complex companies involving parent-subsidiary, inter-and intra-company transactions elevate attention to risk mitigation. For instance, credit agreement often caps subsidiaries third-party debt to prevent "structured subordination" where the borrower relies heavily on subsidiary assets and in the case of the subsidiary's bankruptcy, its debts must be fully settled before any funds for transfer to the borrower company.

Note 8 – Covenants

	Affirmative covenants	Negative covenants	Financial covenants
Definition	Legal commitments within a financial contract, requiring the issuer to perform specified activities or achieve certain benchmark	Limiting or prohibiting certain borrower actions	Maintaining key financial ratios

[82] Please refer to Supervisory Policy Manual (SPM) CR-G-5 Country Risk Management as well.

Example	Maintaining the aircraft according to industry standards	Pledging the aircraft as collateral for additional loans Prohibition from modifying the aircraft without lender approval.	LTV ratio

…

Note 9 – Default events

Examples of events of default

-Non-compliance with affirmative, negative or financial covenants

-Bankruptcy

Examples of remedies

-Debt restructuring which requires substantial creditor's backing (e.g.,75%)

-Injection of funds by parents, subsidiary, joint-venture partners

Examples of airline cases

Hong Kong Airlines Seeks to Restructure $6.2 Billion of Debt – Bloomberg

Airline SAS Gets US Court Approval for $1.2 Billion Rescue Plan – Bloomberg

Western Global Airlines Files for Chapter 11 Bankruptcy Protection – Bloomberg

Note 10 – Jurisdiction

Examples about jurisdiction

The borrower's jurisdiction is a crucial factor in aviation financing, significantly impacting the bank's risk. This jurisdiction primarily influences the lender's rights during aircraft repossession. There are cases where an airline seek for a court judgment in two jurisdiction.

Hong Kong Airlines Seeks to Restructure $6.2 Billion of Debt – Bloomberg

(2)Developing Proposal

Note to trainers

-Trainers should tailor content for specific industries according to the context of the learners. The following discussion is constructed around aircraft financing.

-Trainers should substantiate the terms with required documentation for learners' reference

The table below illustrates the outline of a credit proposal constructed around aircraft financing:

Structured finance proposal for aircraft financing
1.Executive summary -Brief overview of the financing proposal -Highlight of the purpose, amount, and key terms of the aircraft financing 2.Introduction -Description of the aircraft (make, model, year, condition) -Intended use of the aircraft (commercial, private, leasing) 3.Market analysis -current market trends in aircraft financing -analysis of the aviation industry's economic outlook

4.Borrower’s profile

-Detailed background of the borrower’s credit worthiness, financial health, credit history)
-Borrower’s experience and reputation in the aviation sector

5-Financing structure

-Type of financing (e.g., loan, lease, others)
-Terms of financing (e.g., clauses in the terms and conditions)
-Mitigation strategy (e.g. security against the aircraft, additional collateral, others)

6-Risk assessments

-Borrower: credit risk analysis
-Market: aviation industry risk
-Value: valuation and depreciation risk of the aircraft
-Others: legal and regulation risk, compliance risk

7-Collateral valuation

-methods used for aircraft valuation
-current and projected value of the aircraft
-Maintenance and operational costs affecting valuation

8-Compliance and regulatory conditions

-Adherence to aviation and financial regulations
-KYC and AML compliance
-Environmental and safety standards

9-Financial analysis

-Cash flow projections
-Debt-equity ratios
-IRR, Break-event analysis

10-Exit strategy

-Options for refinancing or selling the aircraft
-Contingency plans in case of default

11.Others
-Substantiation with documents (financial statement, aircraft appraisal reports)
-Insurance documentation
-Other legal documents

12.Recommendation
-Summarize the strengths and address potential concerns of the proposal
-Make remarks emphasizing the proposals’ alignment with the lender’s interests

(3) Specializing credit facility per scales, economic sectors, industries and maturity

Note to trainers

Trainers should tailor content for specific industries according to the context of the learners.

The table below illustrates examples of specialized credit facility structure on operating asset financing according to bank client scales with and without intra-group/inter-group credit facilities:

Specializing Credit Facility Per Scales of Clients		
Attributes	General enterprise	Large and complex corporate with or without intra-group/intra-group credit facilities
Risk-return	- Suitable for traditional banking finance suitable for dynamic cash flow patterns and moderate growth. - The borrower's capacity to offer collateral or guarantee	- Suitable for customized banking finance solutions for complex financial structures - Emphasis on corporate growth and asset management
Traditional products	- Commercial loans with more complex terms to fit the specific projects or capital needs - Syndicated loans - Asset-based financing - Letter of credit - Trade financing - Corporate credit cards	- Structured finance options
T&C and covenants to mitigate risk	***Note to trainers*** *Trainers may refer to* *of risk mitigation* Examples - Risk-based pricing - Revenue-based financing Covenant structure - Bank consortium - Escrow accounts	***Note to trainers*** *Trainers may refer to* *of risk mitigation* Examples - Debt service coverage ratio Corporate guarantees - Securitization of assets
Values of the operating assets	- Involves medium to large-scale: e.g., equipment e.g., inventory e.g., real estate Valuation based on - -Assessing the asset's ability to generate future income	- Involves high value assets: e.g., large-scale industrial equipment e.g., real estate portfolio e.g., advanced technology Valuation method - e.g., PV of expected future cash flows

The table below illustrates examples of specialized credit facility structure on operating asset financing according to economic sectors:

Specializing Credit Facility Per Economic Sectors			
	Primary economic sector (example: agriculture, minding)	Secondary economic sector (example: manufacturing, construction)	Tertiary economic sector
Risk-return consideration	- Suitable for risk-adjusted traditional banking finance - Tailored to industries with variable cash flow due to seasonal or market factors - Emphasis on asset-heavy operations and market price fluctuations	- Suitable for traditional banking finance with a focus on capital-intensive projects - Involves medium-to-high risk profiles due to large project scales and market competition	- Suitable for flexible banking finance options - Tailored to businesses with steady cash flow and lower asset intensity
Traditional products	- Commodity-backed loans - Equipment financing	- Industrial loans for equipment and infrastructure - Project financing - Working capital loan	- Business lines of credit
T&C and covenants to mitigate risk	***Note to trainers*** *Trainers emphasize risk mitigation specific to primary sector challenges.* Examples - The borrower needs to hedge against commodity price changes. - The borrower needs to put equipment as collaterals.	***Note to trainers*** *Trainers highlight industry-specific risk mitigation strategies.* Examples - Performance bonds - Warranties - Liens on physical assets	***Note to trainers*** *Trainers focuses on risk mitigation in less tangible asset environments.* Examples - Revenue-based financing
Valuation of operating assets	Given the nature of assets like land, crops and mining equipment, the valuation can be - Market approach (the current market value) - Cost approach (purchase cost less depreciation)	The bank emphasizes on the income approach, valuing assets based on their ability to generate income, especially for manufactured goods and construction projects, based on normal market situation, sensitivity analysis and stress testing	The bank emphasizes on the discounted cash flow method and reflect the intangible nature of assets in services and retail.
Government Support	- *Purpose* To mitigate price risk due to, for example, disastrous situation. - *Special program* e.g., subsidies e.g., price support e.g., disaster relief	- *Purpose* To encourage sustainability - *Special program* e.g., tax incentive e.g., grants for R&D e.g., export credits	- *Purpose* To elevate competitiveness of the businesses. - *Special program* e.g., training programs e.g., market development assistance

The table below illustrates examples of specialized credit facility structure on operating asset financing according to industries:

Specializing Credit Facility Per Industries			
	Industry sector structure	Key bank competitors	Key industry success features
Risk-return consideration	- Focus on market dynamics and regulatory environments - Tailored to the sector's operational norms and risk profiles	- Analyse competitor influence on risk factors and market volatility.	- Align with key success drivers such as innovation, market adaptation, and operational efficiency
Traditional products	- Products must reflect the sector's unique asset and cash flow characteristics	- Customized to offer competitor advantages in the markets	- Designed to enhance the business' core competencies and market positions.
T&C and covenants to mitigate risk	***<u>Note to trainers</u>*** *Trainers emphasize the need to customize financial products and strategies based on the distinct characteristics of each industry.* <u>Examples</u> - Adapted to the typical business models and asset types in each industry.	***<u>Note to trainers</u>*** *Trainers emphasize the need to customize financial products and strategies based on the distinct characteristics of each industry.* - <u>Examples</u> Consider competitive pressures and market share risks	***<u>Note to trainers</u>*** *Trainers emphasize the need to customize financial products and strategies based on the distinct characteristics of each industry.* <u>Examples</u> - Ensure alignment with business growth, sustainability, and market leadership goals.
Valuation of operating assets	Potential methods - Cost approach - Current market value - Income approach - Discounted cash flow approach	Potential methods - Cost approach - Current market value - Income approach - Discounted cash flow approach	Potential methods - Cost approach - Current market value - Income approach - Discounted cash flow approach
Government Support	Refer to particular industry and the economic sector	Refer to the particular industry and the economic sectors	Refer to the particular industry and the economic sectors

The table below illustrates examples of specialized credit facility structure on operating asset financing according to industries:

Specializing Credit Facility Per Terms of Maturity		
	Short term loan	Mid to Long term loan
Risk-return consideration	- Focus on e.g., immediate liquidity needs e.g., credit risk over a short period e.g., fast-changing market condition	- Focus on e.g., mid to long-term financial stability e.g., growth prospects e.g., sustained market presence
Traditional products	- Overdraft facilities - Short-term lines of credit - Invoice financing - Trade credit	- Term loans - Leases - Project financing
T&C and covenants to mitigate risk	***Note to trainers*** *Trainers emphasize the need to customize financial products and strategies based on the distinct characteristics of each industry.* Examples - Current financial metrics - Quick asset turnover	***Note to trainers*** *Trainers emphasize the need to customize financial products and strategies based on the distinct characteristics of each industry.* Examples - Comprehensive valuation method e.g., Discounted cash flow e.g., Income approach for assets with long-term utility
Valuation of operating assets	Examples - Short-term relief programs, - emergency funding - Tax deferrals	Examples - Long-term development loans - Grants - Investment incentives
Government Support	Refer to particular industry and the economic sector	Refer to the particular industry and the economic sectors

3.1.4 Collateral valuation and associated loan risk

Note to trainers
Trainers may recap the fundamental elements of collaterals before going onto the covenants on collaterals related to structured finance.

3.1.4.1 Understanding policy, internal guideline and best practices

(1)Acceptance criteria of collateral
Note to trainers
Trainers should refer to CR-G-7 Collateral and Guarantees for the acceptance criteria of collaterals

(2)Safe custody and access controls
Note to trainers
Trainers should refer to CR-G-7 Collateral and Guarantees for the acceptance criteria of collaterals

(3)Insurance
Note to trainers
Trainers should refer to CR-G-7 Collateral and Guarantees for the acceptance criteria of collaterals

(4)Loan-to-value ratio
Note to trainers
Trainers should refer to CR-G-7 Collateral and Guarantees for the acceptance criteria of collaterals

(5)Concentration limits
Note to trainers
Trainers should refer to CR-G-8 Large exposure and concentrations which is relevant to collaterals as well.

(6)Frequency of revaluation and validity of collaterals
Note to trainers
Trainers should refer to CR-G-7 Collateral and Guarantees for the acceptance criteria of collaterals

(7) Collaterals of related companies
Note to trainers
Trainers should refer to CR-G-7 Collateral and Guarantees for the acceptance criteria of related companies' collaterals.

3.1.4.2 Understanding methods of asset valuation

Note to trainers
Trainers should tailor the content materials according to the context of the learners. The following sample content materials are constructed around significant deals associated with syndicated loans, project finance, asset-based finance, trade finance and so on.

(1)Third party valuation - external valuer
An RP may refer to the asset valuation report provide by an independent party for reference. The RP needs to monitor the asset valuation does not deteriorate faster than the loan repayment rate.

(2)Inhouse valuation – Inhouse valuer
An RP may refer to the discounted present value of the expected cash flow related to the asset over the loan term to ascertain the borrower's repayment capability. The RP needs to derive at least the following scenarios:

-the present value of the expected cash flow under normal business circumstances
-the variation in key factors affecting expected cash flow e.g., interest rate, fuel price, market
-the stress test with extreme conditions e.g., pandemic, climate change disasters; regional situation

(3)Stress testing scenarios[83] [84]
Basel Committee on Banking Supervision established the principles for sound stress testing practices and supervision which states that the effectiveness of risk mitigation techniques should be systematically challenged and assessed systematically under stressed conditions when markets may not be fully functioning and multiple institutions simultaneously could be pursuing similar risk mitigating strategies.

The two case studies below illustrate the systemic impact of significant market value decrease in specific collateral types.

Case
Systemic impacts of China's property market downturn Overview: This case study examines the results of factor stress testing within the property market sector, financial sector, and China's GDP, in light of the ongoing decline in China's property market. It reveals the systemic repercussions of a nationwide decline in property values on various economic sectors and underscores the ineffectiveness of collateral-based mitigation strategies under such conditions. This unprecedent situation in China's property market underscores the critical importance of collateral diversification in credit risk management. Source: China's Evolving Property Crisis and Stress Test Scenarios (factset.com)

[83] Stress Testing, IC-5, Supervisory Policy Manual, Microsoft Word - IC-5-20120507 for issuance .doc (hkma.gov.hk)
[84] Principles for Sound Stress Testing Practices and Supervision, May 2009, Basel Committee on Banking Supervision, Principles for sound stress testing practices and supervision, May 2009 (bis.org)

Case
Bank's response to market value decline in real estate collaterals Content: Banks want to dump the property loans when the market is stressed by high interest rates. Key aspects include: • Impact of high-interest rates: high interest rates can lead to increased borrowing costs, making it difficult for borrowers to service their loans. • Banks' strategy to mitigate risk: faced with the challenge of deteriorating collateral values, banks may look to offload property loans. • Regulatory response: regulators recognizing the systemic risk often step in to stabilize the situation. • Long-term implications: The response of banks and regulators not only impacts the immediate financial landscape but also has long-term implications for the real estate market and overall economic stability. Source: US Regulators Asks Lenders to Help Firms With Commercial Real Estate Stress - Bloomberg

3.1.4.3 Evaluating common practices and refine existing valuation approach

Note to trainers

Trainers should tailor the content materials according to the context of the learners. The following sample content materials are constructed around significant deals associated with syndicated loans, project finance, asset-based finance, trade finance and so on. Other than inviting specialist on the topics in Module 1, the newsroom is a good moment to share collateral cases.

Case
Case outline: A bank had arranged banking facilities up to USD30 million with pledged aluminum, alumina, and copper. It also set up trade financing agreements with the clients. The bank also requested corporate and personal guarantee. Subsequently, it was found that the client had pledged the same stockpile of the metal multiple times for loans, i.e., double pledging or multiple pledging. Source: HSBC Releases Loan Collateral From Company Tied to Qingdao Probe - Bloomberg

Case
Case outline The reliance on paper-based warehouse receipts in the commodity trading sector poses significant risk. The industry trend is to apply more secured standardized and digital system to mitigate the risk. Source: Metals Trading Has a Paper Fraud Problem - Bloomberg

Case
Case outline The reliance on paper-based warehouse receipts in the commodity trading sector poses significant risk. The industry trend is to apply more secured standardized and digital system to mitigate the risk. Source: Metals Trading Has a Paper Fraud Problem - Bloomberg

3.1.4.4 Management information and analytics

(1) Factors affecting determination of accurate market values of assets/collaterals

The table below illustrates the factors affecting the accurate determination of market values of collaterals and the effective steps to ensure up to date information is gathered for monitoring:

Market situation	Historical price trends	Future Economic development	Valuation done by other banks
-analyse current market conditions regularly -focus on supply-demand balance and macroeconomic indicators -adjust loan-to-value ratios based on market changes -maintain collateral values in line with economic realities	-use historical data for trend identification -employ statistical tools for trend analysis -reverse engineering to validate the model accuracy in estimating historic data -incorporate historical volatility into risk models	-integrate macroeconomic forecasts into valuations -recommend update risk factors or weight in the risk models with economic projections -adjust collateral values for future economic shifts -Ensure proactive risk assessment with economic changes	-compare valuation with other banks for benchmarking -identify and rectify valuation discrepancies -establish network to obtain informal exchange of information

3.1.4.5 Maintaining management information and analytics

The table below illustrate the requirement on the management information regarding collaterals, per CR-G-7

Management information	Proposed frequency	Purpose
Breakdown of credit exposure by type of collateral	Monthly	For the identification of concentration risks in the pool of collateral accepted and stress-testing
Borrowings exceeding maximum loan-to-value ratio	Margin financing: daily Others: Monthly	To highlight facilities requiring top-up of collateral
Total current market value of the assets foreclosed in the course of satisfaction of debts	Monthly	To facilitate formulation or modification of strategies for disposal of assets foreclosed
Comparison of latest assessed market value with actual proceeds of collateral sold	Monthly	To facilitate evaluation of the accuracy and validity of methodology for conducting collateral valuations
Current market value of collateral related to each classified credit	Quarterly	For determining the amount of provision required for classified credits

3.1.4.6 Initiating, executing and reviewing changes in value

The table below illustrates the essential considerations during the steps of initiating and executing collaterals and related reviews:

State	Consideration In Initiating and Executing Collaterals			
	Inherent risk	**Determining fair market value**	**Adjusting fair market value**	**Evaluating asset valuation formula**
Initiating	**Maturity mismatch** -identify and manage risk arising from differences in maturity dates between the collateral and the underlying credit exposure. **Currency mismatch** -identify the risk due to currency fluctuations between the collateral and the loan currency.	Conduct comprehensive market research to understand the current value of similar assets	Regularly review and adjust the fair market value to reflect changes in -the market -the asset condition	Critically assess the in-house discount formulas used for asset valuation to ensure they align with -industry standards -regulatory requirement
Executing	Examples Implement strategies like -maturity matching or – -hedging to align the duration -currency swaps -currency futures	Examples Use a combination of valuation methods such as -cost approach -scrap sales value -income approach	Consider factors like -economic trends, -asset deprecation, and -market liquidity in the adjustment process	Test the formulas against historical data and market scenarios to evaluate their accuracy and robustness
Reviewing	Continual review on potential mismatches -draw down -regular review -unforeseen situation (e.g. Ukraine-Russia battles, fuel price)	Engage independent appraisers for -unbiased valuation -compare their findings with internal assessments	Implement a systematic review process to ensure timely updates to the valuation as market conditions evolve	Regularly update and refine the valuation models to incorporate new market data, changing economic indicators, and evolving risk factors

The table below illustrates some systematic ways to evaluate the asset valuation formula:

Systematic Ways to Evaluate the Asset Valuation Formula	
Compare	-Routinely benchmark in-house valuation against external expert assessments -Validate assumptions used by independent valuation firms -Refine the in-house model based on external benchmarks to enhance accuracy
Analyze	-Analyse the quality and sources of data in the in-house model -Continually seek to use more reliable and timely data sources
Assess	-Evaluate in-house model's risk parameters' correlation with changes in collateral value -Regularly adjust risk parameter components and weights to boost model predictability
Embed	-Align the in-house model with current regulatory requirements -Promptly update the model in response to regulatory changes affecting collateral valuation
Integrate	-Utilize advanced analytics for greater predictive accuracy -Conduct scenario analysis and stress testing for asset value assessment under diverse economic conditions
Monitoring	-Authentication of the ownership of collaterals is critical to protect the bank's interest -Maintain regular reports on collateral values and update the model to reflect market changes -Continuously compare model predictions with actual outcomes for ongoing refinement of predictive capability

3.1.4.7 Adjusting risk associated with loan and evaluate adjustment necessity

Note to trainers

Trainers should tailor the content materials as per context of the learners real working environment and management policies.

A sample content structure below includes:

HKMA collateral requirements and loan loss provisioning	Explain HKMA's guidelines on how qualified collaterals can reduce loan loss provisions
Impact of collateral value changes on loan risk	Detail how changes in the value of collaterals directly affect the risk profile of the associated loans
Adjusting loan loss provisions	Provide a step-by-step process for adjusting loan loss provision in response to change in collateral reviews with reference to the management information and reporting requirement
Factors for loan risk adjustment	Outline factors to consider when adjustment loan risks, such as: -market volatility -economic trends -specific characteristics of the collaterals
Regulatory compliance and rating	State the importance of regulatory compliance in the valuation and revaluation of collaterals
Scenario analysis and stress testing	State the deployment of scenario analysis and stress testing will assist the evaluation of the impact of the collateral value to the associated loan risk

3.1.4.8 Seeking remedy and mitigation upon default event

(1) Controversy over collaterals upon default event

Despite explicit terms and conditions and all due diligence performed to ensure secured title over the collaterals, there are examples where the foreclosure of a company upon default are not straight forward. Example could be the foreclosure (or filing the bankruptcy) of an airline ((Example case: Hong Kong Airlines A Restructuring Unparalleled (lw.com)), where the question arose whether the actions served all secured parties or favoured certain lenders. To navigate such scenarios, particularly where liens are equally and pro-rata held by two potentially conflicting credit groups, it's sometimes preferable to appoint an independent third party as the collateral agent.

(2) Collateral allocation mechanism

In lending, lenders are usually treated equally, with each lender in a tranche contributing and receiving payments proportionally to their commitment in that tranche. This includes the allocation of loans, principal, interest, and the reduction of commitment, as well as the distribution of fees within the tranche. While there are principles in the collateral allocation, the explicit terms and conditions in the loan agreement can overrides them.

However, in agreements involving multiple tranches, it's not always feasible to secure all tranches equally and proportionally. This is due to factors such as
-Differing financial assistance regulations across regions
-Tax implication that vary by jurisdiction

This is where the Collateral Allocation Mechanism (CAM) becomes essential, streamlining the allocation and management of collateral. However, the CAM's concept and execution greatly differ based on several complexities:
-Varied regulatory framework
-Different market norms
-Diverse financial instruments
-Varying technological and infrastructural capabilities
-Distinct internal policies of banks
-Contrasting approaches to risk management

(3) Remedies

To the extent that a loan is secured by collateral, an event of default (or acceleration) normally permits the lenders to commence the exercise of collateral remedies. However, the individual lenders may not exercise remedies for a lending syndicate, because collateral are normally granted to the administrative agent (or a collateral agent) for the benefit of the lenders as a group.

The table below provides some examples of remedies:

Example: Recission	Recission conditions -The borrower must have rectified the original event of default that triggered the acceleration -There should be no other intervening defaults or events of default -All default interest accrued on the accelerated principal during the acceleration period must be paid -No judgment or decree should have been entered for the payment of the loan -The right to rescission is restricted if the administrative agent has already commenced the exercise of any judicial remedies
Example: Waterfalls	Waterfalls dictate the order in which funds are distributed when a borrower's payment is less than the total amount owed. They typically apply to scheduled payments and mandatory prepayments, but not to optional prepayments. The hierarchy is listed below for reference only: *-Administrative/collateral agent fees and expenses* These are prioritized for payment before any other claims. *-Interest payments* Interest is paid before the principal amount. *-Term loans* Payment for term loans precedes that for revolving credit loans. *-Revolving credit loans* These are paid next, followed by coverage for any outstanding letters of credit. *-Secured facilities* Payment for protective advances made by individual lenders is prioritized at the same level as the administrative agent's fee and expenses. *-Transactions involving junior collaterals* Payments are first allocated to senior collateral holders before addressing junior collateral claims.
Example: Set off	Setoff is a nonjudicial remedy under common law available to lenders, contingent on two key conditions. *-Mutuality* This requires the involvement of the same two parties, each acting in the same capacity. For example, a bank cannot use a derivatives contract to offset a loan obligation if it involves a third party. *-Maturity* Both obligations must be due and payable. For example, a bank cannot use a time deposit that still has three months before maturity to offset a loan.
Example: Top up collaterals	Top up collaterals mechanism protects the bank by maintaining the loan-to-value ratio within acceptable limits throughout the loan term. If the value of the collateral increases in the future, or the loan principal is paid down to a level that restores the original LTV ratio, the lender may release the additional collateral back to the borrower.

Remark: While there are principles in the remedies, the explicit terms and conditions in the loan agreement can overrides them.

3.1.5 Pricing and affordability

3.1.5.1 Pricing with different acquisition

(1) Understanding regulatory impact on calculation of regulatory and commercial components of internal fund transfer pricing

Note to trainers

Trainers should articulate the specialized knowledge of credit facility related to companies of different scales, industries, economic sectors as well as regulatory environment to the bank's risk-revenue commensuration. The following content materials supplements articulation of regulatory environment to the bank's revenue.

Basel's impact on bank's cost[85] from project financing:

-Increased funding cost: enhanced capital requirements and a stricter definition of capital under Basel III lead to increased funding costs for banks. Project finance loans, in particular, are affected, as banks now incur higher costs to maintain the required capital levels. Estimates suggest that Basel III could raise funding cost by 60 – 100 basis points compared to Basel II
-Shorter loan tenors: The Net Stable Funding Ratio (NSFR) aspect of Basel III influences banks to offer shorter-term project finance loans. The market for long-term loans over seven to ten years is contracting, leading banks to explore different debt structures.

-Increased costs for working capital facilities: Under Basel III, working capital facilities in project financing, particularly for SPV, are likely to required 100% short-term liquidity cover. This requirement makes offering products like revolving credit facilities more costly for banks.

-Impact on letter of credit: Basel III allows national regulators to determine the level of Liquidity Coverage Ratio (LCR) required for letters of credit, a common instrument in project financing. The imposition of LCR cover can increase the costs for banks to provide LCs economically.

The table below shows an example of regulatory impact on bank's cost of funding:

Case – Regulatory Impact on Bank's Cost of Funding
Content: Long-awaited rules tied to Basel III international standards: Banks might face a 20% average increase in overall capital requirements. Source Large Banks' Residential Mortgages Face US Mandates Exceeding Global Standards - Bloomberg

[85] Basel III and the Future of Project Finance Funding (umich.edu)

(2) Understanding pricing of different loan acquisition

Note to trainers

Trainers should tailor the content materials according to the context of the learners on the subject which concerns them most at the timing of training delivery.

The table below illustrates how the different pricing approaches are embedded into the more complex products:

Pricing of Different Loan Acquisition				
	Syndicated Loan	Project Finance	Asset-specific lending	Trade and working capital-based lending
All-in Approach -combines all costs, fees, interest into a single rate	*Different services*			
	-syndication fee	-arrangement fee	-handling fee	-service fees
	-arrangement fee	-project risk and management cost	-valuation cost	-bank charges on trade transactions
			-Collateral management cost	
Credit-rating Approach -based on the borrower's credit rating i.e., perceived risk of default	*Different credit rating*			
	Loan rates vary based on the -collective credit rating of involved parties	Loan rates adjusted according to the -project profile -sponsors' credit worthiness	Loan rates vary based on -borrower's credit rating -quality of the collateral	Loan rate adjusted according to -types of trade transaction
Product and service type-based Approach -based on the specific characteristics and risks of the loan product	*Different product type*			
	Pricing per -complexity -size -term of syndication	Pricing per -duration -sector -cashflow projection	Pricing per -type of assets financed -liquidity of assets	Pricing per -type of transaction e.g., documentary credit e.g., export finance

(3) Understanding pricing approaches

Note to trainers

Trainers should tailor the content materials according to the context of the learners on the subject which concerns them most at the timing of training delivery.

The table below list a sample summary of means for pricing comparison which needs team work rather than single individuals:

Means for Pricing Comparison			
A-Internal pricing comparison			
Historical data analysis *Approach* Review the bank's historical pricing data for similar corporate loans. *Consideration* -Loan size -Duration -Risk profile -Economic sector -Economic conditions	**Risk-based pricing model** *Approach* Utilize internal risk-based pricing models. *Consideration* -Borrower's credit risk -Collateral value -Others	**Cost-of funds analysis** *Approach* Analyse the bank's cost of funds and include a markup. *Consideration* -Risk and return -Benchmark of similar internal loan products	**Internal rate of return (IRR)** *Approach* Calculate the IRR for the loan. ***Consideration*** -Whether the expected return meets the bank's threshold for similar risk profile
B-External pricing comparison			
Market benchmarking *Approach* Compare the proposed loan pricing with prevailing market rates for similar corporate loans. *Reference* Industry reports Financial news Market surveys	**Competitor analysis** *Approach* Gather information on how competing banks are pricing similar loans. *Reference* Published rates. Industry reports Client feedback	**Credit spreads** *Approach* Analyse credit spreads for similar risk profiles in the bond market. *Reference* Insight from the risk premium demanded by the market	-
C-Financial modelling			
Discounted cash flow *Approach* Estimate the present value of expected cash flows from the loan. *Consideration* -Risk premium -Time value of money	**Option pricing model** *Approach* Option pricing modelling for more complex structure *Example* Black-Scholes model for option pricing	**Use of advanced analytics** *Approach* Apply AI, machine learning tools to analyse historical data or market trend for financial model construction	

D-Consultation with experts			
Internal expert Engage with internal teams such as -treasury -risk management -finance *Consideration* -cost structure -risk assessment -market trends -operational risk -liquidity	**External consultants** *Approach* Engage with external financial experts or industry specialist for complex financing. *Consideration* -additional perspectives -proven track record		
E-Regulatory compliance and standards			
Align with guidelines. *Approach* Ensure that the pricing strategy aligns with regulatory requirements and guidelines set forth by the HKMA or other regulatory bodies. *Reference* HKMA, which has also referenced to Basel	**ESG** *Approach* If relevant, include considerations for environmental, social and governance factors, which are increasingly important in corporate financing decisions		
F-Scenario analysis and stress testing			
Interest rate scenarios *Approach* Access how changes in interest rates may impact loan profitability. *Consideration* -interest rates (e.g., rising rates, falling rates, stable rates) -economic conditions (e.g., recession, growth, inflation) -regular changes -geopolitical events	**Economic conditions** *Approach* Evaluate the impact of different economic scenarios on the borrower's ability to repay. *Consideration* The loan's overall profitability		
G-Client relationship and negotiation			
Long-term value *Approach* Fundamental relationship consideration must be accompanied by scientific analysis. *Consideration* -historical relationship -future business potential -strategic importance of the client to the bank			

(4) Understanding and evaluating pricing and cost formula

Note to trainers
Trainers should facilitate the learners to share their knowledge about the approximate framework of revenue formula and to share their insight about improvement.

Internal fund transfer pricing

Note to trainers
Trainers should cover only broadly this topic just to increase the sensitivity of the learners about the macro-interest environment change to the bank's funding cost.

Calculating the cost of lending is as important as giving a competitive pricing to the borrower. The table below contains an example of a HKMA monthly release of composite interest rate.

Press release[86] from HKMA on Nov 17, 2023, about composite interest rate as of end of October 2023 indicated that "the composite interest rate, which is a measure of the average cost of funds of banks, increased by 8 basis points to 2.76% at the end of October 2023, from 2.68% at the end of September 2023. The increase in composite interest rate reflected an increase in the weighted funding cost for deposits during the month."

The table below listed the transformation of composite interest rate calculation

Before June 2019	After June 2019
The composite interest rate[87] is a weighted average interest rate of all Hong Kong dollar interest-rate-sensitive liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and all other liabilities that do not involve any formal payment of interest but the values of which are sensitive to interest rate movement (such as Hong Kong dollar non-interest bearing demand deposits) on the books of banks. Data from retail banks, which account for about 90% of the total customers' deposits in the banking sector, are used in the calculation.	The composite interest rate and weighted deposit rate have been calculated based on the new local "interest rate risk in the bank book (IRRBB)" framework. *About the IRRBB*[88][89] *The IRRBB is the risk posed by adverse movements in interest rates that cause a mismatch between the rates banks set on customer loans and on deposits*[90]*. e.g., If rates were to increase and a bank's deposit repriced sooner than its loans, it could result in the bank paying out more interest on deposits than the interest it is receiving from loans.* *The new approach helps to identify the changes in the economic value of the bank's equity (EVE) which is derived by discounting future cash inflow and outflows.* *Therefore, EVE is specifically used to measure banks' IRRBB in a standardized outlier test, with supervisors entitled to take action if a bank experiences a change in EVE of more than 15% of common equity Tier 1 under the outlier test.*

Remark: According to the HKMA, it should be noted that the composite interest rate represents only average interest expenses. There are various other costs involved in the marking of a loan, such as operating costs (e.g., staff and rental expenses), credit cost and hedging costs, which are not covered by the composite interest rate."

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[86] Hong Kong Monetary Authority - Composite Interest Rate: End of October 2023 (hkma.gov.hk)
[87] Hong Kong Monetary Authority - Composite Interest Rate: End of October 2023 (hkma.gov.hk)
[88] Hong Kong Monetary Authority - Interest Rate Risk Management (hkma.gov.hk)
[89] This module should be read in conjunction with the Introduction and with the Glossary, which contains an explanation of abbreviations and other terms used in this Manual (hkma.gov.hk)
[90] Interest rate risk in the banking book (IRRBB) definition - Risk.net

Overhead and administrative cost

Note to trainers

Trainers should cover only broadly this topic just to increase the sensitivity of the learners about the different dynamics of overhead costs of different banks.

The table below list some examples of the overhead and administrative costs.

Overhead	Administrative Costs
Description Overhead expenses are the costs associated with running the bank as a whole. They are not directly tied to any specific banking service or function but are necessary for the overall operation and maintenance of a bank.	*Description* Administrative expenses are the costs associated with day-to-day administration of the bank and which are more closely related to the specific banking operations and services.
Examples -Facility cost: rent, utilities, and maintenance of bank branches and offices -Technology infrastructure: costs of maintaining and updating IT systems, cybersecurity measures, and digital banking platforms -Marketing and advertising: expenses related to promoting bank services and products -Regulatory compliance: cost associated with complying with banking regulations and audit	*Examples* -Personnel cost: salaries, bonuses, benefits, and training costs for bank employees -Operational costs: day-to-day expenses of running bank operations, such as supplies, equipment, and software. -Risk management: expenses related to managing various risks (credit, market, operational). -Legal and professional fees: fees for legal counsel, consulting, and other professional services. -Transaction processing: cost associated with processing customer transactions, including payment processing fees.

(5) Determining, evaluating, selecting and recommending competitive offer

Note to trainers

Trainers should tailor the content materials according to the context of the learners. This section ties closely to the learning of the previous section on price comparison and a brief summary is sufficient to conclude the section.

Select optimal approach

Integrate internal historical data, risk-based models, and market benchmarks to select an approach that balances loan size, duration, and sector-specific risks with market realities.

Conduct competitive pricing

Leverage competitor analysis, credit spreads, and advanced analytics to establish competitive pricing, ensuring it reflect both internal cost structures and external market conditions.

Evaluate, justify risk and profitability of a deal

Employ scenario analysis, stress testing, and consultation with experts to evaluate and justify each deal's risk against profitability, considering long term client relationships and regular compliance.

3.1.5.2 Affordability

(1) Recommending clients' affordability

Note to trainers

Depending on the client complexity of the learners, Trainers may share experience regarding recommendation on affordability of large and complex clients.

Computing ability to repay debt

Assess the borrower's repayment capacity by calculating the total loan amount, periodic interest obligations, and available funds, time horizon of mid-term or long-term ensuring the debt is manageable within their financial framework.

Proposing adequate time horizon

-mid-term solution: offer financing structures that provide flexibility and stability over a medium timeframe, balancing immediate financial needs with future repayment capabilities.
-long-term solutions: develop long-term financing strategies that align with the borrower's long-term financial goals and business growth projections, ensuring sustainable debt management.

Facilitating client to improve repayment ability and time to repay upon origination

The table below lists examples of suggestions to clients to improve the conditions for better financing terms:

Repayment ability as per debt amount, interest rate and available fund	Time for debt repayment
Advise clients on improving repayment ability by -optimizing cash flow management -reducing unnecessary expenses -exploring revenue-enhancing strategies -maintaining a contingency fund to manage unforeseen financial challenges	-Recommend structuring the loan with a realistic repayment timeline that aligns with the client's cash flow projections and business cycles. -Encourage periodic reviews to adjust the repayment schedule in response to changing financial conditions.

3.1.6 Evaluation of credit acquisition

(1) Tracking and analyzing the hit rate which is subject to specific A.I. and products

Analyzing and identifying the factors to replicate success
Successful cases often exhibit strong creditworthiness, robust collateral, clear repayment plans, and alignment with economic trends.

Analyzing the following elements to model future successful credit strategies and embed into the credit risk model:
-debt service coverage ratio
-collateral quality
-borrower's industry position
-adaptability to market changes

(2) Tracking and analyzing the failed cases

Root cause analysis of factors of failure to improve credit acquisition
Failed credit cases typically stem from overlooked risks or misjudged borrower capabilities. Perform in-depth analysis of credit defaults, focusing on:
-risk assessment oversights
-economic downturn impacts
-borrower liquidity issues
-inadequate collateral valuation

Use the above insights to refine credit risk models, enhancing prediction accuracy and reducing defaults.

3.2 Submodule 2: Consultation, Presentation, Negotiation and Code of Ethics

Note to trainers

-Trainers can pick, change, and repackage the content sample below according to learners' needs.

-In case trainers want to develop in-class learning activities, ***Appendix 11 – Sample – Integrated behavioural checklist developed for Module 3 Submodule 2*** *is an adequate tool to stimulate learners' reflection regarding mastering the essential competencies.*

3.2.1 Overview on code of ethics, communication of risk, behavioral knowledge, and skills

Note to trainers

- *Trainers may develop training materials to fit the learners' context. Ensure that the subject matter of the consultation, presentation, and negotiation dialogues aligns with the learnings from Modules 1, 2, and 3. Trainers will find links in the reference content materials below.*
- *In-house trainers should recommend that the learners complete the in-house general communication courses before enrolling in this advanced and practical module.*
- *As time passes and the learners have more practice according to the consultation, presentation, and negotiation flow, the learners may integrate various application skills.*

3.2.1.1 Ethics and sales compliance

Note to trainers

- *Trainers should refer to both HKMA reference on code of ethics, in-house code of conducts, in house sales compliance.*
- *Trainers must remind the learners to integrate skills for querying to gauge client comprehension and understanding of relevant associated risk involved.*
- *Trainers may refer to Section E7 which provides trainers with refreshers as pre-class learning.*

3.2.1.2 Communicating risk and checking understanding

Note to trainers

Trainers should constantly remind the learners importance of communicating risks to clients, checking clients' understanding and their degree of comprehension.

3.2.1.3 Behavioural knowledge and skills of consultation, presentation and negotiation

The matrix below summarizes essential behavioural knowledge of consultation, presentation and negotiation.

Behavioural Knowledge of Consultation, Presentation and Negotiation			
	Consultation	**Presentation**[91]	**Negotiation**
1 Ethics, compliance and risk	**Compliance** -Code of ethics -Inhouse code of conduct -Sales compliance	**Compliance** -Code of ethics -Inhouse code of conduct -Sales compliance	**Compliance** -Code of ethics -Inhouse code of conduct -Sales compliance
	Risk clarification -Ask questions to check understanding and access comprehension of the client on relevant risk	**Risk clarification** -Ask questions to check understanding and access comprehension of the client on relevant risk	**Risk clarification** -Ask questions to check understanding and access comprehension of the client on relevant risk
2 Nature of dialogues	**Open conversation** -exchange ideas and opinions -no formal agreement	**Buyer-seller exchange** with seller's objective to increase the odds of success and to achieve sales	**Deliberate conversation** -on a particular issue -to reach agreement
3 Parties' relation	**Counterparties** Consultant – client	**Counterparties** Seller – buyer	**Counterparties** Counterparts
4 Principal objective	**Principal objective** Influence	**Principal objective** Persuade	**Principal objective** Facilitate
5 Organizational behaviours[92]	**Sources of influencing**[93] **power** -legitimate -reward -coercive -expert -information -referent	**Principles of persuasion** -Reciprocity -Commitment and consistency -Social proof -Authority -Liking -Scarcity -Unity	**Issues in negotiation** -Personality clash -Gender behaviours -Cultural differences -Unethical negotiation, e.g,, • Selective disclosure • Misrepresentation • Deception and lying • False threats and false promises • Inflicting direct or indirect harm

[91] Principles of Persuasion to Manage Change in Organizations - LeanScape

[92] Organizational behaviour, encompassing the study of individual and group dynamics within an organization, influences the selection of effective communication strategies ensuring more impactful and receptive interactions.

[93] 13.3 The Power to Influence – Organizational Behavior (umn.edu)

Behavioural Knowledge of Consultation, Presentation and Negotiation			
	Consultation	**Presentation**[94]	**Negotiation**
6 Situational Approach / strategy / style	**Situational approaches** -Expert where technical formula is needed -Doctor-Patient where technical information is needed -Process where change is needed -Emergent where transformation is needed	**Situational approaches** -Premium sales[95] where client receives added values -Product sales where client sees success demonstration -Network sales where relationship provide the foundation -Prescriptive sales where solution is offered -Adaptive sales[96] where approach evolves with interactions with clients' responses	**Bargaining mindset**[97] -Distributive (Zero sum) approach, where one win and the other losses e.g., competing style e.g., compromising style -Integrative (Win-win) approach, where both parties become convergent or congruent with one another e.g., collaborating style e.g., compromising style e.g., accommodating style
7 Key success drivers	**Key Drivers** -KYC -Identify client needs	**Key drivers** 1-Knowing the product, the client, the ability to offer solutions during presentation. 2-The ability to adjust the presentation to fit the needs of the current situation. 3-Building the presentation around honesty, sincerity, and integrity.	**Key drivers** -Parties/interests[98] -Business needs -Bottom line -BATNA (best alternative to a negotiated agreement) -Solutions & options -Concessions -Legitimacy -Commitments -Relationships -Communication
8 Success measures	**Evidence-based evaluation**[99] -Logic type i.e. level and type of thinking -Conceptual map i.e. integrated framework of concepts -Logic model i.e. methodologies, processes, and phases -Implementation of logic model i.e. Metrics and measures -Outcome and impact assessment i.e. benefits, costs, consequences, learning	**Willingness and achievement** -The ability to arouse willingness in the client, to continue future interactions. -The degree in which the "preferred solutions" of the salespeople are realized across their client interactions	**Success behaviours**[100] **of Skilled negotiator** -Before negotiation • No. of options considered per issue: e.g. 5.1 • Portion of time spent focusing on anticipated areas of agreement instead of conflict: e.g. 39% -During negotiation • Portion of time spent asking questions of counterpart: e.g. 21% • Portion of time spent in active listening: e.g. 10% • Portion of time spent attacking opponent: e.g. 1%

[94] Principles of Persuasion to Manage Change in Organizations - LeanScape
[95] 4 Effective Sales Approaches to Incorporate Into Your Sales Process | Lucidchart Blog
[96] Welling: Building Partnerships, 9th edition, Weitz, Castleberry & tanner, 2009
[97] 14.4 Negotiation Behavior - Organizational Behavior | OpenStax
[98] Seven keys to effective negotiation | MIT Sloan
[99] A Framework To Evaluate Consulting Efforts - A Peer-Reviewed Academic Articles | GBR (pepperdine.edu)
[100] 14.4 Negotiation Behavior - Organizational Behavior | OpenStax

Behavioural Knowledge of Consultation, Presentation and Negotiation			
	Consultation	**Presentation**[101]	**Negotiation**
9 **Flow**	1-Outlying bank products 2-Prescribing financial solutions 3-Elucidating credit facilities 4-Exploring collateral valuation 5-Outlining pricing and affordability *Note that in each of the stages, clarification of client's understanding and assessment of the client's comprehension is done.*	1-Managing expectation 2-Handling inquiries and objections 3-Observing buying signal 4-Gaining commitment 5-Closing the deal *Note that in each of the stages, clarification of client's understanding and assessment of the client's comprehension is done.*	1-Framing the negotiation 2-Offering value 3-Adapting to situations 4-Gaining commitment 5-Closing the deal *Note that in each of the stages, clarification of client's understanding and assessment of the client's comprehension is done.*
10 **Behavior skill Sets** **Details in section 3.2.1.3**	**Skill sets** -Cognitive Consultation -Presentation -Negotiation	**Skill sets** A-Cognitive, e.g. planning Presentation B-Structured presentation C-Balanced communication D-Nonverbal engagement E-Adaptability and preparedness F-Documentation and tools Examples of fine skills related to above skill sets (A to F) A-Planning B-Structure content delivery B-document and tools C-effective language use C-nonverbal communication C-balanced communication D-responsive D-interactive D-build rapport E-flexibility and contingent planning E-customer centric	**Skill sets** -Cognitive e.g. strategy Negotiation -influence -facilitate -persuade

<u>Note to trainers</u>

For learners who are less familiar with the independent consultation by inhouse consultant teams or third-party team, the following three examples helps them to perceive the huge market in need of consultation on corporate risk mitigation under different circumstances.

[101] Principles of Persuasion to Manage Change in Organizations - LeanScape

List of global-scale independent Consultants
Examples of consulting firms -KPMG -PWC -Accenture -McKinsey Company -Boston Consulting Group **Source:** Top Banking consulting firms in the world (consultancy.org)

Note to trainers

Trainers may use the following mini cases in the Newsroom learning activities suggested in the training package.

Mini case
Sharing In the situation where systemic risks arise, the regulators request the bank to provide consultation to the clients to mitigate risk on both parties. Content outline US Regulators encouraged banks to assist corporations facing commercial real estate stress. This is an example of banks stepping into consultative roles due to emergent market situation. Reference source US Regulators Asks Lenders to Help Firms With Commercial Real Estate Stress - Bloomberg

Mini case
Sharing Large-scale banks have their own independent consultancy arms, highlighting the trend of offering more than just financial products, but also strategic advisory services. Content This mini case makes reference a scenario where inhouse consultant team provides various services to enhance corporate performance. This could involve strategic planning, risk management advisory, and others. Source Treasury Consulting Advisory for Corporate Clients (jpmorgan.com)

3.2.1.4 Behavioural skills of consultation, presentation and negotiation

Note to trainers

- *Trainers should tailor the content materials according to the context of the learners. This section ties closely to the learning of the previous section on behavioural knowledge.*
- *Inhouse trainers may consider recommending the learners to complete the inhouse general communication courses prior to enrolling them with this advanced and practical module.*

Behavioural skills are interpersonal, self-regulatory, and task-related behaviours that connect to successful performance in workplace settings.

The matrix below summarizes essential behavioural skill sets of consultation, presentation and negotiation:

Skill Sets of Consultation, Presentation and Negotiation		
Consultation skills "to influence"	**Presentation skills[102] "to persuade"**	**Negotiation skills "to facilitate"**
Reminder: ensure compliance and clarify clients' understanding on risk		
Approach/tactics/styles		
(Refer section 3.2.1.3, and Refer to Note 1 to 4 below) -Expert -Doctor-Patient -Process -Emergent	(Refer to section 3.2.1.3 and Refer to Note 5 to 9 below) -Premium -Product -Network -Prescriptive -Adaptive	(Refer to section 3.2.1.3 and Refer to Note 10 and 11 below) -Distribution -Integrative
Skill sets		

[102] What_makes_sales_presentations_effective-a_buyer-s.pdf

Refer to section 3.2.1.3 **A-Cognitive skills Planning/strategy** 1 -Technical knowledge 2 -Problem-solving skills 3 -Analytical thinking 4 -Diagnostic skills 5 -Use of tools 6 -Creative problem solving 7 -Systems thinking 8 -Strategic thinking 9 -Long term planning 10 -Adaptability to change 11 -Agility **B-Negotiation skills** 1 -Facilitation skills 2 -Prescriptive Advice 3 -Collaborative Skills **C-Presentation skills** 1 -Clear communication 2 -Empathy 3 -Educational Ability	Refer to section 3.2.1.3 **A-Cognitive Skills Planning/Strategy** 1 -Understanding audience needs Tailoring content to the customer's perspective, connecting benefits to their needs 2 -Developing presentation strategy Combining relationship, product, and customer strategies to determine objectives and step-by-step plan 3 -Building presentation Clearly stating the value proposition and conduct a value analysis. Building around honesty, sincerity, and integrity **B-Presentation Execution (Structured content delivery)** 1 -Setting clear objectives and boundary Keep presentations brief, state objectives, limit objectives 2 -Educating the client Demonstrate the product effectively and provide dramatization if necessary, and clearly articulate features, advantages, and benefits. 3 -Frequently updating client understanding Update frequently, have feedback loop, have transparent and comprehensive information 4 -Having feedback loop to invite queries Check understanding, seek agreement **C-Communication skills (balanced communication)** 1 -Addressing concerns proactively Use humor appropriately, avoid disparaging remarks, and admit minor weaknesses. 2 -Communicating with transparency Disclose adequately all relevant information 3 -Conveying Comprehensive information 4 -Manage uncertainties Look for and utilize responsive behaviour, prepare for difficulties. **D-Engagement skills (non-verbal skills)** 1 -Being Customer-centric Adaptability, Flexibility, with contingency plan: Be prepared for unexpected and presentation difficulties. 2 -Observing non-verbal language	Refer to section 3.2.1.3. **A-Skills anchored to negotiation approach** **Distributive** -Hard tactics 1 -Threat Scare Attack Ultimatum Cut off ties 2 -Time tactics Delay Set a final date Control schedule Set the agenda 3 -Authority related tactics Limited authority Unauthorized Negotiation 4 -Reveal information **Integrative** 5 -Reveal information 6 -Promises 7 -Concession 8 -Communication* - *Influence* -Information strength -Place strength -Power factor - *Facilitation* -Positive tone -Active listening -Empathy - *Persuasion* -Articulation skills -Creative problem solving

	Interpret and use body language, 3 understand nonverbal cues, and use 4 visual aids. -Recognizing interest indicators -Identifying concern resolution 1 **<u>E-Adaptability and preparedness</u>** **<u>skills</u>** 2 -Clarifying potential decision 3 criteria -Summarizing benefits -Stating clear next steps 1 **<u>F-Closing deals (Documentations</u>** 2 **<u>and tools)</u>** 3 -Confirm agreement -Confirm terms and conditions -Confirm needed document	

Note 1	Note 2	Note 3	Note 4
Expert approach	Doctor-patient approach	Process approach	Emergent approach
Predominantly used where specialized knowledge and technical formulae are essential	Predominantly used where an evaluative and diagnostic perspective is needed	Predominantly used where understanding and navigating through a serious of steps are crucial	Predominately used where adapting to changing information and dynamic market situation is key
Example Used for elucidating credit facility structure	Example Used for prescribing customized financial solutions	Example Used for outlining bank products as well as pricing and affordability	Example Used for exploring collateral valuation and associated and relevant loan risk

Note 5	Note 6	Note 7	Note 8	Note 8
Premium Approach	Product approach	Network approach	Prescriptive approach	Adaptive approach
Employed when the bank offers specialized values which aligned with the client's specific needs or preference	Employed when the bank's unique product features are significant to the client	Employed with being part of the bank's network is beneficial to the client.	Employed when the bank's expertise can provide valuable guidance to the client	Employed when there is a need to respond to emerging situation

Note 9	Note 10
Distributive approach	Integrative approach
One of the counterparts wins, the other losses	Both counterparts win, together win more

3.2.2 Consultation Process

3.2.2.1 Pre-consultation preparation on client's needs identification and evaluation

<u>Note to trainers</u>

*(1) Trainers should enable learners to apply prior understanding on "Knowing your customer", "business model", and "the value chain" to identify and assess clients' needs, potential, challenges, opportunities and prospects. (2) -In case trainers want to develop in-class learning activities, **Appendix 8A: Sample - Checklist for Pre-consultation Preparation – A Concise Guide for Effectively Preparing for Client Consultation** is an adequate tool to stimulate learners' reflection regarding mastering the essential competencies.*

The pre-consultation preparation matrix aims to enhance the RPs' abilities in constructing effective consultation sessions. Equipped with prior knowledge about the client's key success drivers, namely, the business, the model and the value chain, the RPs comprehends the client's needs and opportunities and potential options on credit risk management before the consultation session starts. This practical preparation framework aligns with the high expectation on RPs to articulate their suggestions to clients based on facts, data and analytics. It is directly applicable in the RPs' daily professional interactions, ensuring that they are well-prepared for any client consultation scenario.

<u>Matrix – Sample matrix on pre-consultation preparation to identify client's needs</u>

The matrix below summarizes approaches to identify Customer needs, potential, challenges, opportunities and prospects with appropriate approaches:

<table>
<tr><th colspan="4">Identification of Client's Needs, Potential, Challenges, Opportunities and Prospects with Comprehensive Credit Management Skills to Depict Key Business Drivers</th></tr>
<tr><th rowspan="2">Pre-consultation Preparation to identify and evaluate customer's needs</th><th colspan="3">Essential Elements for Identification of Customer Needs</th></tr>
<tr><td>[link to Module 2]
<u>Know your customer</u></td><td>[link to Module 2]
<u>Understand the business model</u></td><td>[link to Module 2 Submodules]
<u>Understand the value chain</u></td></tr>
<tr><td>[link to Module 2 Submodule 1]
<u>Financial analysis</u></td><td>-Understand and evaluate the accounting concepts applied in the client
-Conduct financial ratios analysis</td><td>-Obtain qualitative financial information and associate it with financial ratios
- Analyse key business drivers in coherence with business direction</td><td>-Analyse key business drivers to understand the value chain of the business to have holistic view</td></tr>
<tr><td>[link to Module 2 Submodule 2]
<u>Financial strength</u></td><td>-Conduct critical analysis of financial statements (internal factors)
-Conduct critical analysis of financial statement (external factors)</td><td>-Conduct critical analysis of financial statement (internal critical risk factors)</td><td>-Conduct critical analysis of financial statement with site visits
-Conduct critical analysis of financial statement (to evaluate business model)</td></tr>
<tr><td>[linked to Module 2 Submodule 3]
<u>Credit risk analysis</u></td><td>-Conduct budget and pro-forma analysis to help identify client's purpose and objectives for loan demand</td><td>-Conduct budget and pro-forma analysis to estimate the business or project value
-Conduct quantitative analysis and risk assessment to evaluate business model achievability</td><td>-Conduct quantitative analysis and risk assessment to evaluate value chain sustainability e.g., impacts to value chain
-Structure credit facility to know impact on balance sheet e.g., debt-equity ratios</td></tr>
<tr><td rowspan="2">Clarifications with questions</td><td colspan="3">To fill up gaps between coherence of plan, actuals and outcomes of business strategy, model and value chain</td></tr>
<tr><td colspan="3">To clarify the future potential, challenges, and opportunities</td></tr>
</table>

3.2.2.2 Consultation flow, Approaches and Skill Sets to Customize Consultancy Services

<u>Note to trainers</u>

Trainers should enable learners to apply prior understanding on "Knowing your customer", "business model", and "the value chain" to identify and assess clients' needs, potential, challenges, opportunities and prospects.

-In case trainers want to develop in-class learning activities, ***Appendix 8B: Sample - Checklist for effective consultation session – Ensuring Comprehensive Coverage and Risk Assessment*** *is an adequate tool to stimulate learners' reflection regarding mastering the essential competencies.*

The reference content materials below contain a matrix developed to enhance the learners' consultation flow.

<u>Consultation matrix of flow, approaches and skill sets to customize consultancy service</u>

A sample matrix is established of consultation flow, approaches and skill sets for

- Identifying client's needs
- explaining features, risk levels, alternatives, ensuring understanding
- customizing consultancy service on credit risk per financial situations and needs
- advising alternatives on investment and settlement method

The consultation matrix consists of five sequential stages, each focusing on different aspects of the customized consultation service:

<u>(1)Flow</u>

The consultation session is structured into five distinct steps:

Stage 1: Outlining bank products and associated risk
Stage 2: Prescribing financial solutions, reveal associated risk
Stage 3: Elucidating credit facilities and associated risk
Stage 4: Exploring collateral valuation and associated relevant loan risk
Stage 5: Outlining pricing and affordability and associated risk

<u>(2)Approach</u>

Each step of the consultation process utilizes a specific approach, tailored to the nature of the consultation:

In each of the above stages, client's understanding and degree of comprehension of the associated risk must be checked and reconfirmed.

Stage 1: Outlining bank products
Approach: Process approach - This stage involves discussing a range of banking products and their unique features, which are suitable for different borrowers needs

Stage 2: Prescribing financial solutions
Approach: Doctor-patient approach - This stage centres on customizing financial solutions based on credit strategy, sponsor's credit worthiness, and risk factors impacting terms and conditions.

Stage 3: Elucidating credit facility structure
Approach: Expert approach – This stage focuses on tailoring financial packages, including terms and conditions, for varied scales, sectors, and industries.

Stage 4: Exploring collateral valuation
Approach: Emergent approach – This stage addresses collateral valuation, asset valuation, risk adjustment, and mitigation strategies.

Stage 5: Outlining pricing, affordability
Approach: Process approach – this final stage guides through regulatory impacts on funding costs, various pricing strategies, and the evaluation of competitive offers (to full extent to inhouse approver and to adequate extent if necessary to the client).

<u>Matrix-sample matrix on consultation flow and consultation approaches</u>

The matrix below summarizes consultation process and approaches for different stages:

Matrix on Consultative Flow and Consultative Approaches					
Flow Refer to section 3.2.1.2.		**Consultation approach** Refer to section 3.2.1.2.			
		Expert approach	**Doctor-patient approach**	**Process approach**	**Emergent approach**
Stage 1	Outlining bank products			✓	
Stage 2	Prescribing financial solutions		✓		
Stage 3	Elucidating credit facility structure	✓			
Stage 4	Exploring collateral valuation and associated loan risk				✓
Stage 5	Outlining pricing and Affordability			✓	
Remark: RPs must include elucidation of risk in each stage of the above flow					

Part (1) of the table below illustrates the application of the above matrix sample on consultation flow and approaches. Part (2) of the table below demonstrates the communications with the client to clarify the understanding of the risk and assess the degree of comprehension.

Application of matrix on consultation flow and approaches

Practical Application of the Matrix on Consultation Process and Consultative Approaches	
Part (1) Consultation Flow and Approach	
Stage 1	**Consultative consultation approach**
	Process Approach
Outline bank products	-Large scale and consortium-based lending -Project and specialized financing -Asset-specific lending -Trade and working capital based lending -General corporate lending -Overview of bank product unique features affecting suitability of borrower
Stage 2	**Consultative Consultation Approaches Upon Circumstances**
	Expert Approach
Prescribe financial solutions	-Banks' credit strategy (for approver only) -Credit worthiness of sponsor -Risk factors of the application affecting tailoring of terms and conditions -Assessing aligned needs of assets and debt-equity structure adequacy -Identifying financing means for structuring deals -Balancing client's asset-liability portfolio
Stage 3	**Consultative Consultation Approaches Upon Circumstances**
	Expert Approach
Elucidate credit facility structure	-Tailor-made financial package options -Terms and conditions for agreement -Proposal on tailored -Specialized credit facility structure for various scales, sectors, and industries -Time horizon considerations
Stage 4	**Consultative Consultation Approaches Upon Circumstances**
	Emergent Approach
Explore collateral valuation and associated loan risk	-Understanding policy and best practices for collateral -Asset valuation -Factors affecting determination of accurate market values of assets/collaterals -Managing information and analytics -Initiating, executing, reviewing value (inherent risk, fair market value) -Adjustment of risk associated with loan and evaluate adjustment necessity -Remedy and mitigation
Stage 5	**Consultative Consultation Approaches Upon Circumstances**
	Process Approach
Outline pricing and affordability	-Regulatory impact on calculation of funding cost (for approver only) -Different approaches of pricing -Comparative pricing strategies -Calculate and evaluate revenue formula -Determining, evaluating, selecting and recommending competitive offers -Evaluate, justify risk and profitability of a deal
Part (2) Clarifying client's understanding on risk and assessing degree of comprehension	
Consult on bank products	• Confirm understanding of risk implication in large scale and consortium-based lending • Assess comprehension of risk factors in project and specialized financing

Consult on customize financial solutions	• Evaluate client's understanding of risk assessment in its debt-equity strategy • Verify comprehension of risks related to creditworthiness and repayment history
Consult on credit facility structure	• Confirm understanding of risks associated with specific terms and conditions of credit facilities • Assess comprehension of risks in tailored financial package options
Consult on collateral valuation and associated loan risk	• Verify client's understanding of collateral risk management, including loan-to-value ratios and revaluation • Assess comprehension of inherent risks in asset valuation and risk adjustments necessary for loans
Consult on pricing and affordability	• Confirm understanding of risk implications in different pricing approaches • Evaluate client's grasp on risk and profitability considerations in deal evaluation

(3)Matrix-sample matrix on consultation approaches and skill sets

Note to trainers

Once learners confidently apply each skill in its respective consultation stage, they can begin to blend these skills innovatively across different consultation stages for more dynamic and effective client engagement.

The matrix below summarizes the consultative skills for different consultative approaches:

Consultation Skills for Different Consultative Approaches				
Consultation skill sets Refer to section 3.2.1.3.	Consultative approaches			
	Expert	Doctor-patient	Process	Emergent
Cognitive skills				
Technical knowledge	✓			
Problem-solving skills	✓			
Analytical Thinking	✓			
Detail orientation	✓			
Diagnostic Skills		✓		
Use of tools		✓		
Long term planning			✓	
Strategic thinking				✓
Creative problem solving				✓
System Thinking				✓
Adaptability to change				✓
Adaptability				✓
Agility				✓
Presentation skills				
Clear communication		✓		
Empathy		✓		
Interpersonal communication		✓		
Prescriptive advice		✓		
Educational ability			✓	
Negotiation skills				
Facilitation skills			✓	
Collaborative skills			✓	

3.2.3. Presentation process

Note to trainers

- *Trainers should help the learners to associate their previous learning to the presentation process.*
- *Trainers may tailor the content materials according to the context tailored to the learners*

3.2.3.1. Pre-presentation preparation with experts to increase the odds of success

The pre-presentation preparation matrix design enables RPs to master the key success drivers of an effective presentation before the actual session takes place. An RP prepares a presentation with the collaboration of experts (a veteran RP can be an expert by oneself) to enhance knowledge and skills, anticipating potential inquiries and objections and ensuring an RP builds the presentation around key success drivers tailored to current needs and built upon a foundation of honesty, sincerity, and integrity.

Matrix-Sample matrix on pre-presentation preparation with experts to build an effective presentation

The matrix below summarizes pre-presentation preparation with experts' collaboration to prepare for profound technical responses to anticipated inquiries, objections, different scenarios and to build a presentation:

Matrix on Pre-presentation Preparation with Experts[103] to Build Effective Presentation -to increase the odds of success & to forecast inquiries and objections			
Pre-presentation Collaboration with	**Key drivers to successful presentation** Refer to 3.2.1.2.		
	Knowing the product, customer, solution offering	**Adjusting the presentation to current needs**	**Building the presentation on honesty, sincerity, and integrity**
Collaborating with experts			
Product	-Enhancing product knowledge		
Credit	-Clarifying risk tolerance		
Sales	-Deepening competitor insights	-Adjusting presentation based on insight	
Legal & compliance	-Ensuring regulatory and legal compliance		-Ensuring legal integrity and sales compliance in the presentation
Treasury	-Exploring funding solutions and pricing formula		
Information technology	-Providing tailored analytics		
Preparing profound professional response with technical competency and adaptation to			
Anticipated of technical inquiries	-Developing response to anticipated technical inquiries about the products		
Anticipated of objections	-Developing anticipated objection	-Adapting responses as per audience needs	
Scenario planning	-Anticipating various scenarios to be presented	-Tailoring presentation to different scenarios	
Building the presentation	-Embedding experts' insight to be presented		-Build on a foundation of honesty and integrity

[103] Hong Kong Monetary Authority - Risk Management (hkma.gov.hk)

Sample Application of Matrix on Pre-presentation Preparation with Experts for Effective Presentation

The example below shows sample application of the above "Matrix on Pre-presentation Preparation", with asset financing solution to illustrate.

Practical Application of the Matrix on Pre-presentation Preparation			
	Key drivers to successful presentation		
Work with experts for advanced preparation	**Knowing the product, customer, solution offering**	**Adjusting the presentation to current needs**	**Building the presentation on honesty, sincerity, and integrity**
Collaborate with experts			
Product	Enhance knowledge on asset-specific loans, legal charge on assets		
Credit	Clarify risk tolerance in asset financing, such as loan-to-value (LTV) handling of collaterals and problem loans, in case happens		
Sales	Provide insights on industry-specific financing (e.g., automotive, manufacturing)	Adjust presentation based on industry needs	
Legal & compliance	Check compliance in asset-based financing, mortgage and legal charge implications		Ensure legal integrity and sales compliance in the presentation
Treasury	Offer solutions for funding and maturity and currency mismatch risk		
Information technology	Provide data related to asset financing, such as repayment performance		
To prepare profound professional response with technical competency and adaptation to			
Anticipated technical inquiries	Prepare answers on -asset valuation -legal charge -loan features		
Anticipated objections	Develop responses to potential objections on asset-based financing terms	Adapted responses as per audience needs and concerns	
Scenario planning	Anticipate scenarios in asset financing, including normal market, sensitivity analysis and stress analysis	Tailor presentation to different scenarios	
Building the presentation	Incorporate insights on asset-based financing products, risk management		Build presentation with clarify on asset financing terms and conditions

3.2.3.2.Presentation flow, approaches and skill sets to close deals

Note to trainers

Trainers should enable learners to apply prior understanding on "Knowing your customer", "business model", and "the value chain" to identify and assess clients' needs, potential, challenges, opportunities and prospects.

*-In case trainers want to develop in-class learning activities, **Appendix 9: Sample - Checklist for presentation** is an adequate tool to stimulate learners' reflection regarding mastering the essential competencies.*

The reference content materials below contain a matrix developed to enhance the learners' presentation flow.

Presentation matrix of flow and approaches and skill sets to customize presentation

A sample matrix is established of presentation flow, approaches and skill sets for

- Gaining client commitment, and
- Closing deals with client satisfaction

The sample matrix consists of five sequential stages, each focusing on different aspects of the customized presentation:

(1)Flow

The presentation session is structured into five distinct steps:
Step 1: Managing expectation
Step 2: Handling inquiries and objections
Step 3: Observing buying signal
Step 4: Gaining commitment
Step 5: Closing a deal with customer satisfaction

(2)Approach

Each step of the presentation process is designed with specific strategy to align with its unique demands. In each stage below, the RP must check and reconfirm client's understanding and degree of comprehension of the associated risk.

Stage 1: Managing expectation
Approach: Structured Presentation – Focus on delivering information in a clear, educational manner to set realistic expectations.

Stage 2: Handling inquiries
Approach: Balanced communication – Address inquiries with transparency and depth, ensuring thorough understanding.

Stage 3: Observing buying signal
Approach: Nonverbal engagement – Identify buying signals through attentive observation and nonverbal cues.

Stage 4: Gaining commitment
Approach: Adaptability and preparedness – Clarify, summarize, and highlight key decision-making factors to gain client commitment.

Stage 5: Closing deal
Approach: Documentation and tools – Use documentation and tools to ensure clarity and agreement on terms for a successful deal closure.

Matrix-sample matrix on presentation flow, approach and skill Sets

The matrix below shows the presentation flow and presentation approaches

Matrix on Presentation Flow and Presentation Approaches					
	Presentation Flow Refer to 3.2.1.2				
	Stage 1	**Stage 2**	**Stage 3**	**Stage 4**	**Stage 5**
Sales approaches/tactics adopted to the stages of presentation flow Refer to 3.2.1.2	Manage expectation	Handle inquiry	Observe buying signal	Gain commitment	Close the deal
A-Approaches					
Situational approaches (Pick one or more for different stages for the presentation session) -Premium sales - where client receives added values -Product sales - where client sees success demonstration -Network sales - where relationship provide the foundation -Prescriptive sales = where solution is offered -Adaptive sales - where approach evolves with interactions with clients' responses					
B-Skill Sets					
Structured Presentation					
Setting clear objectives and boundary	✓				
Educating the client	✓				
Frequently updating client understanding	✓				
Having feedback loop to invite queries	✓				
Balanced Communication					
Addressing concerns proactively		✓			
Communicating with transparency		✓			
Conveying Comprehensive information		✓			
Managing uncertainties		✓			
Non-verbal engagement					
Observing non-verbal language			✓		
Recognize interest indicator			✓		
Identify concern resolution			✓		
Adaptability and preparedness					
Clarifying potential decision criteria				✓	
Summarizing benefits				✓	
Stating clear next steps				✓	
Documentation and tools					
Confirming agreement					✓
Confirming terms & conditions					✓
Confirming needed documents					✓

(3)Matrix-Sample matrix of presentation flow, approaches, behaviours and skills

<table>
<tr><th colspan="6">Matrix on skills integration to presentation flow</th></tr>
<tr><td rowspan="2">Skill sets
Refer to 3.2.1.2</td><td colspan="5">Presentation Flow</td></tr>
<tr><td>Manage expectation</td><td>Handle inquiry</td><td>Observe buying signal</td><td>Gain commitment</td><td>Close the deal</td></tr>
<tr><td colspan="6">Structured presentation</td></tr>
<tr><td colspan="6">A-Approaches (The choice affects the summarized benefits to the clients)</td></tr>
<tr><td colspan="6">Choose situational approach(es)
(Pick one or more for different stages for the presentation session)
<table><tr><th>Premium sales</th><th>Product sales</th><th>Network sales</th><th>Prescriptive sales</th><th>Adaptive sales</th></tr><tr><td></td><td></td><td></td><td></td><td></td></tr></table></td></tr>
<tr><td colspan="6">B-Skill Sets (The same skill set applied for different choices of approach)</td></tr>
<tr><td colspan="6">Structured presentation</td></tr>
<tr><td>Setting clear objectives and boundary</td><td>B[104]-structured content delivery</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Educating the client</td><td>B-structured content delivery
B-document and tools</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Frequent updating client understanding</td><td>C-effective language use
C-nonverbal communication
C-balanced communication</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Have feedback loop to invite queries</td><td>D-responsive
D-interactive
D-build rapport</td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="6">Balanced communication</td></tr>
<tr><td>Addressing concerns proactively</td><td></td><td>D-responsive
D-interactive</td><td></td><td></td><td></td></tr>
<tr><td>Communicating with transparency</td><td></td><td>D-responsive
D-interactive</td><td></td><td></td><td></td></tr>
<tr><td>Conveying comprehensive information</td><td></td><td>D-responsive
D-interactive</td><td></td><td></td><td></td></tr>
<tr><td colspan="6">Non-verbal engagement</td></tr>
<tr><td>Managing uncertainties</td><td></td><td>E-flexibility and contingent planning</td><td></td><td></td><td></td></tr>
<tr><td>Recognizing interest indicator</td><td></td><td></td><td>C-nonverbal communication
D-responsive</td><td></td><td></td></tr>
<tr><td>Identifying concern resolution</td><td></td><td></td><td>D-responsive</td><td></td><td></td></tr>
<tr><td colspan="6">Adaptability and preparedness</td></tr>
<tr><td>Clarifying potential decision criteria</td><td></td><td></td><td></td><td>E-customer centric</td><td></td></tr>
<tr><td>Summarizing benefits</td><td></td><td></td><td></td><td>E-customer centric</td><td></td></tr>
<tr><td>Stating clear next steps</td><td></td><td></td><td></td><td>E-customer centric</td><td></td></tr>
<tr><td colspan="6">Documentation and tools</td></tr>
</table>

[104] Refer to the presentation skill set in Overview section

Confirming agreement					B-document and tools
Confirming terms and conditions					B-document and tools
Confirming needed documents					B-document and tools

Sample Application

The matrix below shows samople application of the above "matrix on skill integration to presentation flow", with asset financing solution to illustrate:

Practical Application of the matrix on skills integration to presentation flow	
	Presentation Flow
Stage 1	**Manage expectation**
Set clear objectives and boundary	Introduce asset-based financing, its purpose in business strategy. (B-structured content delivery)
Educate the client	Explain products, types of loans, and industries served. (B-structured content delivery)
Frequent update about client understanding	Discuss usability of assets, focusing on cash flow management, risk mitigation (C-effective language, non-verbal, balanced communication
Have feedback loop to invite queries	Encourage questions on legal charges, asset-specific loans, and SPVs. (D-Responsive, interactive, build rapport)
Stage 2	**Handle inquiry**
Address concerns proactively	Respond to concerns: risk-weights, regulatory implications, specialized aspects. (D-responsive, interactive)
Transparent communication	Clearly explain asset valuation, credit limit determination, and loan agreement (D-responsive, interactive)
Comprehensive information	Provide detailed information on asset monitoring, process, repayment terms. (D-responsive, interactive)
Manage uncertainties	Discuss flexibility in aircraft financing, address risk management & compliance. (E-flexibility and contingent plan)
Stage 3	**Observe buying signal**
Recognize interest indicator	Observe client's interest in specific assets of financing options. (C-nonverbal communication, responsive)
Identify concern resolution	Note resolution of concerns, indicating readiness for further discussion.
Stage 4	**Gain commitment**
Clarify potential decision criteria	Discuss and broaden the client's decision-making criteria related to asset-based loan, risk assessment, and financing option. (E-customer centric)
Summarize benefits	Highlight benefits of choosing asset-based financing for their specific needs. (E-customer centric)
State clear next steps	Outline next steps for obtaining asset-based financing. (E-customer centric)
Stage 5	**Close the deal**
Confirm agreement	Review and confirm the terms of the financing agreement. (B-documentation and tools)
Confirm terms and conditions	Ensure all terms and conditions are understood and agreed upon. (B-documentation and tools)
Confirm needed documents	Finalize required documentation for the financing process. (B-documentation and tools)

3.2.4. Negotiation process

3.2.4.1. Pre-Negotiation preparation to plan negotiation strategy

Note to trainers

*In case trainers want to develop in-class learning activities, **Appendix 10A: Sample - Checklist for pre-negotiation preparation** is an adequate tool to stimulate learners' reflection regarding mastering the essential competencies.*

The reference content materials below contain a matrix developed to enhance the learners' negotiation flow.

Negotiation matrix of flow and approaches and skill sets to customize negotiation

The pre-negotiation preparation tool is a thinking tool designed to enable RPs to focus on building an effective negotiation session around the key success drivers like BATNA and span of options. It guides RPs to thoroughly identify negotiation styles, from distribution-based to integrative-based, and to address personality, gender, culture, and ethical considerations, while focusing on substance, relationships, and strategic outcomes. The comprehensive framework prepares RPs to effectively navigate negotiations, ensuring ethical compliance and optimal outcomes in various aspects such as risk, revenue and client relationships. Besides, it aligns with the high expectations of RPs to base their suggestions on facts, data, and analytics. It is directly applicable in the RP's daily professional interactions, ensuring that they are well-prepared for any negotiation scenarios.

The template "pre-negotiation preparation" below is a comprehensive thought process facilitating 360 degrees of integration of knowledge of organizational behaviours, key success drivers of negotiation and structured flow into practical negotiation tactics.

Part I: Aligning Balanced Offer to Negotiation Key Drivers

STEP 1 – Template Part (I) Developing a balanced offer (1 – 10)

Part II: Adapting Balanced Offer to Negotiation Situations

STEP 2 – Template Part II A-Evaluating negotiation paradigm (A1 – A3)

STEP 3 – Template Part II B- Evaluating negotiation positions (B1 – B3)

STEP 4 – Template Part II C-Anticipating concerns and objections (C1- C3)

STEP 5 – Template Part II D-Assessing client's counteroffer (D1 – D8)

STEP 6 – Template Part II E-Exit (E1 – E3) and overall negotiation tactics

Part III: Formulation of Negotiation Tactics

Task (8) state the negotiation tactics with insights generated from the above Step 1 to 6 analysis.

Task (8) is an executive summary of the insight generated and documented in different tasks under different parts of the matrix:

Part	Task	Task Description
I	1	Capture insight on negotiation tactics – from analysis of the ten key success drivers
	2	Recommend/structure Bank's balanced offer
IIA	3	Analyze negotiation paradigm and potential clash
IIB	4	Evaluate negotiation strength
IIC	5	Anticipate concerns and evaluate their impact on the Bank's balanced offer
IID	6	Anticipate the client's counteroffer and evaluate the Bank's adaptation
IIE	7	Develop and execute exit strategy
III	8	Formulate overall negotiation tactics based on insights from the above Tasks 1 to 7

TEMPLATE – PRE-NEGOTATION PREPARATION

Part (I) ALIGNING BALANCED OFFER TO NEGOTIATION'S KEY DRIVERS

STEP 1 - DEVELOPING A BALANCED OFFER (Complete 1 - 10)

(A)Strategic alignment on 6 key success drivers of negotiation

1-Interest[105]: In interest-based negotiations, the intent is to reach a mutually agreed acceptable outcomes, sometimes that is mutually beneficial to both parties.
2-Business needs: Revealing from financial analysis, financial strength and credit strength analysis regarding the immediate business needs mutually beneficial to both parties.
3-Bottom line: The lowest acceptable point or the final offer a party is willing to accept in a negotiation.
4-BATNA: Best alternative to a negotiated agreement, defined as the most advantageous alternative that a bank can take if negotiation fail, and an agreement cannot be made
5-Option: Available choices parties might consider satisfying their interests, including conditions, contingencies and trades.
6-Concession: Making adjustments on certain demands or positions to facilitate reaching an agreement

How to fill in the template?

Note 1:"Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the I-interim summary

	Key Drivers	Bank's Perspective	Client's Perspective
1	Long term interest – strategic purpose	Q:Refer to the Bank's credit strategy, what are our goals for the future? How do this align with this negotiation?	Q-Refer to the client's business strategy, what are the client's long-term business objectives? How can we align with them?
	• Must have	***I1a-Fill in the blank below:***	***I1d-Fill in the blank below:***
	• Should have	***I1b-Fill in the blank below:***	***I1e-Fill in the blank below:***
	• Nice to have	***I1c-Fill in the blank below:***	***I1f-Fill in the blank below:***
	I1g-Bank-client gap – insight from above analysis		
2	Short term interest – business need	Q-Refer to the Bank's business strategy, what immediate business needs must this negotiation address?	Q-Refer to the outcomes of the financial analysis on the client, what are the client's current financial priorities?
	• Must have	***I2a-Fill in the blank below:***	***I2d-Fill in the blank below:***
	• Should have	***I2b-Fill in the blank below:***	***I2e-Fill in the blank below:***
	• Nice to have	***I2c-Fill in the blank below:***	***I2f-Fill in the blank below:***
	I2g-Bank-client gap – insight from above analysis		
3	Bottom line – the least we can accept	Q-Refer to inhouse analytics from similar cases for worst case, base case and best case, what is our minimum acceptable outcome from this negotiation?	Q-Refer to inhouse analytics on the same client for worst case, base case and best case, what might be the client's minimum expectations?
	• Financial	***I3a-Fill in the blank below:***	***I3c-Fill in the blank below:***
	• Non-financial	***I3b-Fill in the blank below:***	***I3d-Fill in the blank below:***
	I3e-Bank-client gap – insight from above analysis		
4	BATNA – (Best Alternative to a Negotiated Agreement)	Q-Refer to inhouse analytics of similar cases for BATNA in worst, base, and best BATNA, what is out best alternative?	Q-Refer to inhouse analytics on the same client's cases for BATNA in worst, base, and best BATNA, what is client's best alternative?
	Tangible	***I4a-Fill in the blank below:***	***I4c-Fill in the blank below:***
	Intangible	***I4b-Fill in the blank below:***	***I4d-Fill in the blank below:***

[105] Interest-based negotiation, Neil Katz & Kevin McNulty, 1995, Interest-Based Negotiation (syr.edu)

5	Bank's options of offers and client's possible counteroffers (Minium 5 options[106])	Q-What's our base offer? Refer to inhouse analytics on the same client's cases	Q-What's the counteroffer? Refer to inhouse analytics on the same client's cases
	• Option 1	***I5a-Fill in the blank below:***	***I5f-Fill in the blank below:***
	• Option 2	***I5b-Fill in the blank below:***	***I5g-Fill in the blank below:***
	• Option 3	***I5c-Fill in the blank below:***	***I5h-Fill in the blank below:***
	• Option 4	***I5d-Fill in the blank below:***	***I5i-Fill in the blank below:***
	• Option 5	***I5e-Fill in the blank below:***	***I5j-Fill in the blank below:***
6	Solutions/Concessions causing (or not) deviation	Q-What's our potential concession?	Q-What's the client's expected concession?
	• Option 1	***I6a-Fill in the blank below:***	***I6d-Fill in the blank below:***
	• Option 2	***I6b-Fill in the blank below:***	***I6e-Fill in the blank below:***
	• Option 3	***I6c-Fill in the blank below:***	***I6f-Fill in the blank below:***

STRATEGIC ALIGNMENT ON LEVERAGE COMPONENTS OF NEGOTIATION (B)

Smoothen the negotiation process leveraging on legitimacy, commitment, relationship and communication.

7-Legitimacy: establish the fairness, process and outcomes and justifiability of the negotiation process and outcomes
8-Commitment: establish dedication to the negotiation process and adherence to any agreed terms
9-Relationship: establish the interpersonal and professional dynamics to maintain or enhance the relationship
10-Communication: establish effective exchange of information, proposals, and feedback throughout the negotiation

How to fill in the template?

Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)

	Key Drivers	Bank's Perspective	Client's Perspective
7	Legitimacy		
	• Strong	***I7a-Fill in the blank below:***	***I7c-Fill in the blank below:***
	• Weak	***I7b-Fill in the blank below:***	***I7d-Fill in the blank below:***
8	Commitment		
	• Strong	***I8a-Fill in the blank below:***	***I8c-Fill in the blank below:***
	• Weak	***I8b-Fill in the blank below:***	***I8d-Fill in the blank below:***
9	Relationship		
	• Strong	***I9a-Fill in the blank below:***	***I9c-Fill in the blank below:***
	• Weak	***I9b-Fill in the blank below:***	***I9d-Fill in the blank below:***
10	Communication		
	• Strong	***I10a-Fill in the blank below:***	***I10c-Fill in the blank below:***
	• Weak	***I10b-Fill in the blank below:***	***I10d-Fill in the blank below:***

I-Interim summary on expected outcomes *(Use template softcopy for extra space)*

Task (1) Capture insight on negotiation tactics - from analysis of the ten key success drivers
Task (2) Recommend/structure Bank's balanced offer.

[106] Multiple equivalent simultaneous offers which are of the same value to the bank but allows the client to choose the one with biggest perceived values meeting its long term and short term interest.

Part (IIA) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 2 – EVALUATING NEGOTATION PARADIGM

A-NEGOTIATION PARADIGM

How to fill in the template?

Note 1:"Q" = Facilitating Question

Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)

Note 3: Fill in the IIA interim summary

IIA-Fill in the information.

Counterpart	Name	Dept	Title	Decision Authority
Bank				
Client				
…				

	Attributes	Distributive Paradigm i.e. win-loss	Integrative Paradigm i.e. win-win
A1	Anticipated Paradigm	Position-based[107] Distributive i.e. win-loss	Interest-based Integrative i.e. win-win
		IIA1a-Circle the party(s) likely to demonstrate the above paradigm: ***1-Bank 2-Client***	***IIA1b-Circle the party(s) likely to demonstrate the above paradigm:*** ***1-Bank 2-Client***
A2	Anticipated behavioural clashes	Factors leading to higher propensity for position-based/distributive paradigm: Personality: competitive Gender: assertive Culture: distinctive norm	Factors leading to higher propensity for interest-based/integrative paradigm: Personality: withdrawing Gender: collaborative Culture: diversified
		IIA2a-Circle the party(s) likely to demonstrate above behaviours: ***1-Bank 2-Client***	***IIA2b-Circle the party(s) likely to demonstrate the above behaviours:*** ***1-Bank 2-Client***
A3	Anticipated ethical boundary	Unethical negotiation -Manipulative -Coercive -Do not anticipate	Unethical negotiation -Excessive concession -Do not anticipate
		IIA3a-Circle the party(s) likely to demonstrate above behaviours: **1-Bank 2-Client**	***IIA3b-Circle the party(s) likely to demonstrate above behaviours:*** **1-Bank 2-Client**

IIA-Interim summary on expected outcomes ***(Use template softcopy for extra space)***

Task (3) Analyze negotiation paradigm and potential clash.

[107] Interest-Based Negotiation (syr.edu)

<table>
<tr><td colspan="4">Part (IIB) ADAPTING BALANCED OFFER TO SITUATIONS</td></tr>
<tr><td rowspan="20">STEP 3 – EVALUATING NEGOTIATION POSITIONS</td><td colspan="3">B – POSITION STRENGTH</td></tr>
<tr><td colspan="3">How to fill in the template?
Note 1: “Q” = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the IIB-interim summary</td></tr>
<tr><td rowspan="6">B1</td><td colspan="3">Information strength
Strong: Having comprehensive data on the client’s financial history, market trends, and regulatory changes.
Medium: Possessing general knowledge about the client’s industry and basic financial information
Weak: limited understanding of the client’s specific business model or market condition</td></tr>
<tr><td>Q-What’s the level of Strength (choose 1)</td><td>Distributive i.e. win-loss
Time Tactics | Reveal information</td><td>Integrative i.e. win-win
Communication Tactics | Reveal information | Promises | Concession</td></tr>
<tr><td>Strong</td><td>Time-set the agenda
Revealing information</td><td>Revealing information
Communication-Active listening (~20% time)</td></tr>
<tr><td>Medium</td><td>Time-control schedule</td><td>Concession
Promises</td></tr>
<tr><td>Weak</td><td>Time – delay</td><td>Communication -Active listening (~20% time)</td></tr>
<tr><td></td><td>IIB1a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:

1-Bank 2-Client</td><td>IIB1b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:

1-Bank 2-Client</td></tr>
<tr><td rowspan="6">B2</td><td colspan="3">Place strength
Strong: Negotiating from a position where the bank is primary financier or has substantial leverage over the client
Medium: A balanced relationship where both parties have comparable bargaining power
Weak: The client has multiple financing options besides your bank, reducing your leverage</td></tr>
<tr><td>Q-What’s the level of Strength (choose 1)</td><td>Distributive i.e. win-loss
Time Tactics | Authority</td><td>Integrative i.e. win-win
Communication Tactics | Reveal information Concession</td></tr>
<tr><td>Strong</td><td>Time-threat ultimatum</td><td>Revealing information</td></tr>
<tr><td>Medium</td><td>Time-set final date</td><td>Concession</td></tr>
<tr><td>Weak</td><td>Authority-limited authority</td><td>Communication-Active listening (~20% time)</td></tr>
<tr><td></td><td>IIB2a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:

1-Bank 2-Client</td><td>IIB2b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:

1-Bank 2-Client</td></tr>
<tr><td rowspan="6">B3</td><td colspan="3">Power factor
Strong: Holding a significant advantage like exclusive rights to a necessary resource or a dominant market position
Medium: Having a good reputation in the industry, or unique expertise that is valuable but not exclusive
Weak: Limited influence over the negotiation outcome, perhaps due to a lack of unique offerings or lower market standing</td></tr>
<tr><td>Q-What’s the level of Strength (choose 1)</td><td>Distributive i.e. win-loss
Hard Tactics | Authority</td><td>Integrative i.e. win-win
Communication Tactics | Reveal information Concession | Promises</td></tr>
<tr><td>Strong</td><td>Hard tactics – attack
Hard tactics – cut off ties</td><td>Promises</td></tr>
<tr><td>Medium</td><td>Authority – unauthorized negotiation</td><td>Communication-Active listening (~20% time)</td></tr>
<tr><td>Weak</td><td>Authority – limited authority</td><td>Concession</td></tr>
<tr><td></td><td>IIB3a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:

1-Bank 2-Client</td><td>IIB3b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:

1-Bank 2-Client</td></tr>
<tr><td colspan="4">IIB-Interim summary on expected outcomes (Use template softcopy for extra space)
Task (4) Evaluate negotiation strength</td></tr>
</table>

Part (IIC) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 4 - ANTICIPATING CONCERNS AND OBJECTIONS

C-CONCERNS & OBJECTIONS

How to fill in the template?

Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Add your response below each appropriate question chosen
Note 4: Fill in the interim summary

Counterparts		**Bank's Perspective** **Concrete Substance**	**Client's Perspective** **Concrete Substance**	**Bank & Client** **Relationship**
C1	Maximum Gain	**Choose the approach per analysis in A:**	**Choose the approach per analysis in A:**	**Choose the approach per analysis in A:**
		***IIC1a-Win-lose approach*:** Q-What is the bank's maximum gain in this negotiation?	***IIC1c-Win-lose approach:*** Q-What might be the client's utmost desired outcome?	***IIC1e-Trust & mutual agreement approach:*** Q-What common ground can both parties find to foster a mutually beneficial relationship?
		IIC1b-Trust & mutual agreement approach: Q-How can the bank balance its interests with maintaining a long-term client relationship?	***IIC1d-Trust & mutual agreement approach:*** Q-How can the client's need be met while fostering a trusting relationship with the bank	
C2	Anticipate concerns	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**
		IIC2a-Win-lose approach: Q-What potential challenges or objections might the bank face, and how to turn this into opportunities.	***IIC2c-Win-lose approach:*** Q-What key concerns or hesitations might the client have regarding the bank's terms?	***IC2e-Trust & mutual agreement approach:*** Q-What shred concerns might both parties have and how can these be collaboratively addressed?
		IIC2b-Trust & mutual agreement approach: Q-What concerns might arise that could affect the long-term client relationship?	***IIC2d-Trust & mutual agreement approach:*** Q-How can the client's concerns be addressed to build trust in the negotiation process?	
C3	Anticipate objections	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**
		IIC3a-Win-lose approach: Q-What specific objections might the bank anticipate from the client and how can these be strategically countered?	***IIC3c-Win-lose approach:*** Q-What objections is the client likely to raise, and what are their underlying interests?	***IIC3e-Trust & mutual agreement approach:*** Q-How can both parties anticipate and manage objections to protect and enhance their relationship?
		IIC3b-Trust & mutual agreement approach: Q-How can the bank address objections in a way that preserves or enhances the relationship with the client?	***IIC3d-Trust & mutual agreement approach:*** Q-In what ways can the client's objections be resolved to strengthen trust and cooperation?	

IIC-Interim summary on expected outcomes ***(Use template softcopy for extra space)***

Task (5) Anticipate concerns and evaluate their impact on the Bank's balanced offer

Part (IID) ADAPTING BALANCED OFFER TO SITUATIONS			
STEP 5 – ASSESSING CLIENT' S COUNTEROFFER	**D-IMPACT OF CLIENT'S COUNTEROFFER**		
	How to fill in the template? *Note 1:Q = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)* *Note 3: Fill in the interim summary*		
		Bank's Perspective **Distributive (win-loss)**	**Bank's Perspective** **Integrative (win-win)**
	D1	Compliance risk – code of ethics, inhouse code of conduct, sales compliance ***IID1a-Win loss approach – Fill in the blank below:***	Compliance risk – code of ethics, inhouse code of conduct, sales compliance ***IID1b-Trust & mutual agreement approach– Fill in the blank below:***
	D2	Risk tolerance ***IID2a- Win loss approach – Fill in the blank below:***	Risk tolerance ***IID2b-Trust & mutual agreement approach– Fill in the blank below:***
	D3	Application risk ***II31a- Win loss approach– Fill in the blank below:***	Application risk ***IID3b-Trust & mutual agreement approach - – Fill in the blank below:***
	D4	Portfolio risk exposure ***IID4a- Win loss approach– Fill in the blank below:***	Portfolio risk exposure ***IID4b-Trust & mutual agreement approach – Fill in the blank below :***
	D5	Revenue ***IID5a- Win loss approach– Fill in the blank below:***	Revenue ***IID5b-Trust & mutual agreement approach - Fill in the blank below:***
	D6	Cost ***IID6a- Win loss approach– Fill in the blank below:***	Cost ***IID6b-Trust & mutual agreement approach – Fill in the blank below:***
	D7	Trust ***II71a- Win loss approach– Fill in the blank below:***	Trust ***IID7b-Trust & mutual agreement approach – Fill in the blank below:***
	D8	Relationship ***IID8a- Win loss approach: – Fill in the blank below.***	Relationship ***IID8b-Trust & mutual agreement approach – Fill in the blank below:***
	IID-Interim summary on expected outcomes ***(Use template softcopy for extra space)*** *Task (6) Anticipate the client's counteroffer and evaluate the Bank's adaptation.*		

Part (IIE) ADAPTING BALANCED OFFER TO SITUATIONS			
STEP 6 – EXIT STRATEGIY	**E-EXIT STRATEGY**		
	How to fill in the template? *Note 1:Q = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)* *Note 3: Fill in the interim summary.* *Note 4: Fill in the overall summary*		
	E1	Triggering event	***IIE1a - Fill in the blank below:***
	E2	Timing of exit	***IIE2b - Fill in the blank below:***
	E3	Likelihood to execute exit plan	***IIE3c-Fill in the blank below.***
	IIE-Interim summary on expected outcomes ***(Use template softcopy for extra space)*** *Task (7) Develop and execute exit strategy.*		

. . .

Part (III) Formulation of Negotiation Tactics **III-OVERALL SUMMARY - FORMULATION OF OVERALL NEGOTIATION TACTICS** *Task (8) Formulate overall negotiation tactics based on insights from Tasks 1 – 7 in Parts I to IIE*

3.2.4.2.Negotiation process

Note to trainers

*In case trainers want to develop in-class learning activities, **Appendix 10B: Sample - Checklist for negotiation skills** is an adequate tool to stimulate learners' reflection regarding mastering the essential competencies.*

The reference content materials below contain a matrix developed to enhance the learners' negotiation flow. The effective negotiation flow rides on content and tactics derived from the negotiation preparation and contains the essential elements already covered in the above section on pre-negotiation preparation.

Negotiation matrix of flow, approaches and skill sets to customize negotiation

A sample matrix is established on negotiation flow, approach and skill sets for

- Gaining client commitment, and
- Closing deals with client satisfaction

The negotiation matrix consists of five sequential stages, from framing the negotiation to closing the deal, making aware of the approaches and adapting to the negotiation with skills of influencing, persuading and facilitating.

(1)Flow

The presentation session is structured into five distinct steps:

Step 1: Framing the negotiation.
Step 2: Creating values for both counterparts.
Step 3: Adapting to situations.
Step 4: Gaining commitment.
Step 5: Closing a deal with customer satisfaction.

(2)Approach

With thorough pre-negotiation preparation, each step of the negotiation process is anchored upon the planned negotiation strategy built upon either the distributive approach (win-loss), or integrative approach (win-win), with readiness to adapt the balanced offer according to the negotiation dynamics:

In each of the above stages, client's understanding and degree of comprehension of the associated risk must be checked and reconfirmed.

Stage 1: Framing negotiation
Approach: Distributive, or integrative

Stage 2: Offering values.
Approach: Distributive, or integrative

Stage 3: Adapting to situations.
Approach: Distributive, or integrative

Stage 4: Gaining commitment.
Approach: Distributive, or integrative

Stage 5: Closing deal.
Approach: Distributive, or integrative

Negotiation Interaction Guide

This guide is structured to help learners understand how to interact effectively in negotiations, especially when facing a counterpart using a different approach. It details tactics used in the distributive approach which focuses on maximizing individual gain, and the corresponding skills required by the counterpart employing an integrative approach, which seeks mutual benefit and collaboration.

	Principal bargaining approach		**Associated Skills**			
	Distributive	**Integrative**	**Distributive approach**		**Integrative approach**	
			Principal skills of distributive approach	Adequate response to the distributive approach	Principal skills of integrative approach	Adequate response to the integrative approach
1 Hard tactics	✓	✗	-scare -attack -ultimatum -cutoff ties *i.e., threaten to blow the negotiation and turn to BATNA*	*Response tactic* -maintain high EQ	-	-
2 Time tactics	✓	✗	-set the agenda -control *schedule* *-set a final date* *-delay* *i.e., threaten to blow the negotiation and turn to BATNA*	*Response tactic* -maintain high degree of patience	*If apply this tactic* -make use of time to build relation or understanding	
3 Authority tactics	✓	✗	-limited authority -unauthorized negotiation	*Response tactic* -maintain high level of prudence	*If apply this tactic* *-make use of authority to arrive at collaborative solutions*	
4 Information	✓	✗	-reveal information	*Response tactic* *-active listening* *-empathy*	-reveal information	
5 Promise	✗	✓	*Response tactics* *-conditional concession* state that concession will be given if expectation met	*Response tactic* -Avoid giving unilateral concession	-Promise of reward for cooperation	

6 Concession	✗	✓	*Frame the negotiation.* *-label a concession* Label a concession that it is costly hence reluctant to give it	*Response tactic* -Active listening -Empathy	-Giving concession and add value to the deal	
7 Communication	✗	✓			-influence -persuasion -active listening empathy	*Response tactic* -Be comfortable with silence

Sample explanation of the matrix (from the perspective of responding to distributive approach of negotiation):

Hard tactics (Distributive): When facing tactics like scaring, attacking, or ultimatums, the counterpart adopting the integrative approach should maintain high emotional intelligence (EQ), for example, staying calm, composed, and seeking to understand the underlying concerns driving such aggressive tactics.

Time tactics (Distributive): When facing tactics like controlling the agenda, the schedule or delaying, the counterpart adopting the integrative approach should maintain patience and using the time to build understanding or relationships. This response might turn time into an opportunity for deeper engagement rather than a pressure tactic.

Authority tactics (Distributive): When facing tactics like playing the authority card or engages in unauthorized negotiation, the counterpart adopting the integrative approach should exhibit prudence, while leveraging the situation to guide the conversation towards collaborative solutions that respect both parties' authority and decision-making processes.

Information (Distributive and integrative): When facing tactics like revealing information, the counterpart adopting the integrative approach should exhibit active listening and empathy. These skills help in accurately understanding the counterpart's position and crafting a response that aligns with mutual interests.

Concession (Distributive): If facing tactics like reluctance to give concessions, labelling them as costly, the counterpart adopting the integrative approach should focus on understanding the value of these concessions and exploring alternatives that offer additional value to both parties.

Promise (Distributive): If facing tactics like being offered conditional concessions upon certain meeting certain expectation of the negotiation, the counterpart adopting the integrative approach should avoid unilateral concessions and, instead, proposing cooperative rewards. This means aligning concessions when expectations met the benefit of both sides.

Communication (Distributive and Integrative): Effective communication is key in any negotiation but in different styles in the distributive versus the integrative approach. The counterpart adopting the integrative approach should focus on being influential and persuasive, steering the conversation towards mutual understanding and agreement. The counterpart adopting the distributive approach might prefer silence of minimal interactions.

Integrative approach and relevant skills

Active listening in context: Vital in understanding the counterpart's perspective, needs, and concerns. (Benefit: Foster trust and rapport, leading to a more open and collaborative negotiation environment.)

Empathy in context: Empathy involves genuinely understanding and sharing the feelings of the counterpart. (Benefit: Helps in building a strong relational foundation, crucial for long-term business relationships.)

Multiple Equivalent Simultaneous Offers in context: Involves presenting several options equally acceptable offers at once. (Benefit: Provides a clear understanding of what the counterpart values most, paving the way for more targeted and effective negotiations.)

Concessions in context: Strategic concessions are made to advance the negotiation towards a mutually beneficial outcome. (Benefit: Signals flexibility and a willingness to collaborate, which can encourage reciprocation from the counterpart.)

Promises of rewards for cooperation in context: Utilizing persuasive techniques and influential communication to guide the negotiation towards favourable outcomes. (Benefit: Helps in shaping the negotiation constructively while ensuring that key interests and goals are effectively communicated and understood.)

(3)Negotiation Flow and Skill Matrix

– when the negotiator has higher negotiation position to influence the agenda and the time.

Skills	**Framing the negotiation**	**Offering value**	**Adapting to situations**	**Gaining commitment**	**Closing the detail**
To influence[108] -setting clear objective and boundary -educating the client -frequent updating client understanding -have feedback loop to invite queries	✓				
To persuade -Offering balanced recommendation -Offering MESO		✓			
To facilitate -Having active listening -Demonstrating empathy -Assessing counteroffer			✓		
To facilitate -Making promises -Giving concessions				✓	
To facilitate[109] -Confirming agreement -Confirming terms and conditions -Confirming needed documents					✓

Note: Exiting the negotiation when the reciprocal concession causes outcomes below the bottom line.

[108] Refer to presentation skills regarding managing expectation.

[109] Refer to presentation skills regarding closing deal

4 Support Materials – Learner's Self-Study and Extended Learning

List of suggested self-study reading materials

<u>Note to trainers</u>
Trainers may modify the reading list as per learners' needs and provide the list to the learners before classes.

Module 1	**Module 2**	**Module 3**	**Unit of Competencies Useful website/links on**
X			109271L4 Monitor the risk level of the loan portfolio to identify early risk signal <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109266L5 Develop risk mitigation strategies for the credit portfolio <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109268L5 Manage and control the risks of the credit assets for enterprise banking <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109267L5 Conduct stress testing and analyze the results <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109270L5 Conduct ongoing monitoring of borrowing accounts <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109273L5 Conduct post approval and credit monitoring and review on problem loan <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109319L5 Develop internal policies, guidelines, and standards for different operations to comply with regulatory requirements <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u>

Module 1	**Module 2**	**Module 3**	**Units of Competency Useful website/links on**
	X		109256L5 Review risk assessment on credit application <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109257L5 Structure the Credit Facilities <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109260L5 Assess credit and financial strength of borrowers and prepare credit proposal <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u> 109502L5 Conduct company analysis to identify client's needs <u>Qualifications Framework Secretariat (hkqf.gov.hk)</u>

Module 1	Module 2	Module 3	Units of Competency Useful website/links on
		X	109257L5 (Credit) Structure the credit facility Qualifications Framework Secretariat (hkqf.gov.hk) 109258L5 (Credit) Evaluate the performance of credit acquisition and make suggestions Qualifications Framework Secretariat (hkqf.gov.hk) 109259L5 (Credit) Provide consultancy service to clients on credit risks Qualifications Framework Secretariat (hkqf.gov.hk) 109260L5 (Credit) Assess credit and financial strength of borrowers and prepare credit proposal Qualifications Framework Secretariat (hkqf.gov.hk) 109269L5 (Credit) Evaluate market value and marketability of collateral and identify the risks associated with the loan Qualifications Framework Secretariat (hkqf.gov.hk) 109293L5 (large corporation) Structure the credit facilities for large scale operating assets financing programmes Qualifications Framework Secretariat (hkqf.gov.hk) 109502L5 (Sales) Conduct company financial analysis to identify client's needs Qualifications Framework Secretariat (hkqf.gov.hk) 109503L5 (Sales) Present financial solutions to general enterprise banking clients Qualifications Framework Secretariat (hkqf.gov.hk) 109504L5 (Sales) Negotiate with the clients to finalise the customized financial solutions Qualifications Framework Secretariat (hkqf.gov.hk)

Module 1	Module 2	Module 3	HKMA SPM Useful website/links on
X	X		Hong Kong Monetary Authority - Supervisory Policy Manual (hkma.gov.hk)
			Corporate Governance of Locally Incorporated Authorized Institutions CG-1.pdf (hkma.gov.hk) CR-G-1 General Principles of Credit Risk Management CPY Document Title (hkma.gov.hk) CR-G-2 Credit Approval, Review and Records CPY Document Title (hkma.gov.hk) CR-G-3 Credit Administration, Measurement and Monitoring CPY Document Title (hkma.gov.hk) CR-G-5 Country Risk Management General Principles of Credit Risk Management (hkma.gov.hk) CR-G-6 Interest Recognition General Principles of Credit Risk Management (hkma.gov.hk) CR-G-7 Collateral and Guarantees General Principles of Credit Risk Management (hkma.gov.hk) CR-G-8 Large exposures and risk concentrations CR-G-8 (hkma.gov.hk) CR-G-9 Exposures to Connected Parties CR-G-9 (hkma.gov.hk) CR-G-10 Problem Credit Management General Principles of Credit Risk Management (hkma.gov.hk) CR-G-12 Credit Risk Transfer Activities Supervisory Policy Manual (SPM): CR-G-12 Credit Risk Transfer Activities (hkma.gov.hk) CR-G-13 Counterparty Credit Risk Management CR-G-13 Counterparty Credit Risk Management (hkma.gov.hk) CR-G-14 Non-centrally Cleared OTC Derivatives Transactions – Margin and Other Risk Mitigation Standards Non-centrally Cleared OTC Derivatives Transactions – Margin and Other Risk Mitigation Standards (hkma.gov.hk)

Module 1	Module 2	Module 3	International Standards Useful website/links on
X			Revisions/clarifications to policy proposal in consultation paper on implementation of Basel III Reform Package (C20.02) Document (hkma.gov.hk) **Basel Committee Publications - Principles for the Management of Credit Risk - Oct** 2000 (bis.org) **Standardized Approach: Credit Risk Mitigation** CRE22 - Standardised approach: credit risk mitigation (bis.org) **IFRS8 loan provisioning** Origin IFRS8 Loan Provisioning – Impact on bank profit volatility

Module 1	Module 2	Module 3	SME, Personal and Mortgage Loan Useful website/links on
	X		GLN 5.1.1. Motor Vehicle Financing https://www.hkma.gov.hk/eng/regulatory-resources/regulatory-guides/guidelines/1992/08/guide_511b/ SME Financing Guarantee Scheme, The Hong Kong Mortgage Corporation Limited, SME Financing Guarantee Scheme (hkmc.com.hk) Risk Management of Personal Lending Business Our Ref (hkma.gov.hk) Prudential Measures for Mortgage Loan on Non-residential Properties Prudential Measures for Mortgage Loans on Non-residential Properties (hkma.gov.hk)

Module 1	Module 2	Module 3	HKMA SPM – Ethics and Practices Useful website/links on
		X	Code of Ethics CG-3.pdf (hkma.gov.hk) Competence and Ethical Behavioral CG-6.pdf (hkma.gov.hk) Code of Banking Practices Code of Banking Practice (hkma.gov.hk)

Module 1	Module 2	Module 3	HKMA SPM – Hedging with Derivatives Useful website/links on
		X	Chapter 1: Risk and Returns words_e.pdf (hkma.gov.hk) Chapter 2: Some Fundamentals of Derivatives Unknown (hkma.gov.hk) Chapter 3: Pricing of a forward contract and the yield curve Unknown (hkma.gov.hk) Chapter 4: Forwards and Futures Unknown (hkma.gov.hk) Chapter 5: Swaps Derivatives in Plain Words (hkma.gov.hk) Chapter 6: Different types of Swaps Derivatives in Plain Words -- Chapter 6 (hkma.gov.hk) Chapter 7: Duration and Convexity Derivatives in Plain Words (hkma.gov.hk) Chapter 8: Introduction of Option Derivatives Article No. 11 (hkma.gov.hk) Chapter 9: Delta and Volatility Derivatives in Plain Words Chapter 9 (hkma.gov.hk) Chapter 10: Trading Option is Trading Volatility Derivatives in Plain Words Chapter 10 (hkma.gov.hk) Chapter 11: The Gamma of an Option Derivatives in Plain Words Chapter 11 (hkma.gov.hk) Chapter 12: Mortgage Backed Securities Derivatives in Plain Words (Chapter 12) (hkma.gov.hk) Chapter 13: Hedging with Derivatives Derivatives in Plain Words (Chapter 13) (hkma.gov.hk) Chapter 14: Credit Derivatives Derivatives in Plain Words (Chapter 14) (hkma.gov.hk) Chapter 15: Value at Risk Derivatives in Plain Words (Chapter 15) (hkma.gov.hk) Chapter 16: Hang Seng Index and HIBOR Derivatives Derivatives in Plain Words (Chapter 16) (hkma.gov.hk) Chapter 17: Managing Risk in Banks Derivatives in Plain Words (Chapter 17) (hkma.gov.hk)

H. APPENDIX

Appendix 1 – UoC Performance Requirements

On the following pages, the performance requirements/ILO of the selected UoC are listed.

Module 1 - UoC 109271L4 - Monitor the risk level of the loan portfolio to identify early risk signal (Level 4 with 3 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Demonstrate proficient knowledge in credit risk management in order to identify the most appropriate method in risk monitoring - Understand the credit strategies and portfolio objectives of the bank in order to identify crucial areas for monitoring
2	Application	Be able to - Monitor and ensure credit administration is in compliance with contractual requirements and facility terms - Track risk indicators or credit quality (e.g., delinquency, risk rating trends) and detect changes in risk characteristics of loan portfolios. - Identify early signals of delinquency or system risk and escalate to appropriate parties for prompt remedial actions
3	Professional Behaviour and attitude	Be able to - Identify the sources and causes of the changes in risk level, e.g., underwriting standards, economic conditions, personnel issue and recommend appropriate corrective actions - Demonstrate professionalism by applying impartial and unbiased judgment throughout the loan portfolio assessment process - Regularly review the advantages and weaknesses of forecasting and reviewing approaches and adopt the most reliable measure - Report to senior management about the results of analysis on risk profile of overall loan portfolio

Module 1 - UoC 109266L5 - Develop risk mitigation strategies for the credit portfolio (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Demonstrate professional knowledge in credit risk management in order to maintain an optimal risk level for credit portfolio. - Demonstrate professional knowledge in credit management by utilizing different tools (e.g., setting exposure limits, credit derivative) in managing credit risk and their performance in different economic scenarios. - Understand the impacts on business environment caused by the changing external factors and apply the knowledge to evaluate current and future economic outlook and regulatory development for the purpose of developing suitable strategies in risk mitigation.
2	Application	Be able to - Evaluate the credit strategies and existing risk exposure of the bank in order to construct a suitable risk management approach. - Conduct analysis on the trends on risk level of the credit portfolio in order to identify critical factors which can affect the risk level. - Construct strategies in diversifying concentration risk, e.g., reducing exposures to particular type of loan, broaden customer base, altering product mix, industry etc. - Formulate measures to protect the bank from undue risk exposure by employing suitable techniques, e.g., asset sales, securitization, credit derivatives, etc. - Develop policies and procedures for applying different types of credit mitigation techniques. - Develop guidelines and standards on reporting to management when the aggregate exposure is approaching or exceeding portfolio limits.
3	Professional Behaviour and Attitude	Be able to - Manage the activities of credit risk mitigation strategies to ensure they are applied at the right time and used for their purported purposes. - Conduct regular review on the results of the mitigation instructions and provide suggestions on necessary changes.

Module 1 - UoC 109267L5 - Conduct Stress Testing and analyse the results (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Possess specialized knowledge in stress testing and apply it to evaluate different methods of execution in order to develop a suitable approach for the bank. - Understand the credit strategies and portfolio objectives of the bank and based on that evaluate the existing portfolio of credit assets. - Understand the Current macroeconomic environment and trends and consider these as key factors of stress testing.
2	Application	Be able to - Identify factors (e.g., financial data, economic variables) that can impose effects on risk level of loan portfolio and develop financial models to quantify the sensitivity of loan performance to different scenarios. - Analyse existing performance/potential risks of the portfolio in order to determine the objectives for stress testing. - Design methodology, analysis framework and tools on stress testing which are aligned with the objectives of the testing. - Develop testing plan and conduct the test by altering assumptions in different variables and record the effect on portfolio credit quality. - Analyse the performance of different assets and liabilities under the various hypothetical scenarios. - Analyse the results of stress testing and identify the vulnerability of different segments of loan portfolio
3	Professional Behavioural and attitude	Be able to - Consolidate the results of stress testing into the risk management process and develop suitable measures. - Develop contingency plans for vulnerable segments. E.g., strengthening the supervision process, imposing limits, devising existing strategies

Module 1 - UoC 109268L5 - Manage and control the risk of the credit assets for enterprise banking (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Demonstrate professional knowledge in managing risk of credit assets by applying it to evaluate different risk management strategies for the purpose of designing a most suitable approach to the bank. - Understand the credit strategies and portfolio objectives of the bank in order to build an alignment between the selected risk management approach and the bank's strategy
2	Application	Be able to - Assess the situation in order to identify the most suitable approach in risk management and develop the execution plan. - Design risk management measures to diversify risks into different uncorrelated or less correlated business. - Mitigate credit risk by acquiring security, insurance, third party guarantee. - Identify factors affecting the value of the credit assets for assessing the purchase or selling price in order to quantify the risks
3	Professional Behavioural and Attitude	Be able to - Evaluate effectiveness of different approaches of risk management for the purpose of transferring or mitigating credit risk - Review current risk management measures and provide suggestions on improvement based on results of evaluation of different approaches for transferring or mitigating credit risks

Module 1 - UoC 109270L5 - Conduct ongoing monitoring of borrowing accounts (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Demonstrate proficient knowledge in risk management in order to identify the most appropriate method in borrowing account risk monitoring. - Understand the process of credit monitoring and evaluate the performance of client's accounts to compare with the credit strategies and portfolio objectives of the bank to identify critical areas for further follow-up actions. - Keep up to date on the future development and current performance of clients' business/participating industry
2	Application	Be able to - Analyse client's historical information, account profile, account activities/pattern, business outlook, predicted future activity, financial and business data, etc. for identifying risk levels. - Monitor indicators of credit quality (e.g., delinquency, risk rating trends) and identify changes in risk characteristics of loan portfolio. - Perform on-site inspection and regular due diligence review to identify early signals or delinquency. - Analyse the customers, products activity, and financial transactions profile of bank clients to track if any irregularities occur. - Monitor client's borrowing accounts and advise them of new or alternative services to meet their changing needs.
3	Professional Behavioural and Attitude	Be able to - Identify causes and sources of risks and report to appropriate parties for prompt remedial actions. - Restructure debts of clients to improve clients' financial stability and solvency, when it is necessary.

Module 1 - UoC 109273L5 - Conduct post approval credit monitoring and review on problem loans (Level 5 with 4 credits)

<table>
<tr><td colspan="3">Performance Requirements /ILO</td></tr>
<tr><td>1</td><td>Knowledge</td><td>Be able to
- Understand theories and knowledge in banking lending in order to analyse the situation in different cases of problem loans.
- Demonstrate professional knowledge in problem loans management (e.g., common causes for problem loan, early warning signals) by applying it to identify the root causes of different problem loans</td></tr>
<tr><td>2</td><td>Application</td><td>Be able to
- Evaluate the repayment record and transaction records of different accounts of the clients in order to identify possible causes for delay in payment.
- Review the accuracy of past documentation (e.g., collateral valuable report, risk assessment, tracking report) and timeliness of problem identification in order to identify possible root causes for problem loans.
- Consolidate information from different sources in order to analyse the changes in financial situations of the clients when compared to the time of loan origination.
- Compare the loan with lending guidelines to identify any deviation from the agreed principles.
- Determine the account of provision for problem accounts and assess the impact on the bank's credit portfolio</td></tr>
<tr><td>3</td><td>Professional Behavioural and Attitude</td><td>Be able to
- Evaluate information related to current and projected financial status of applicants, hence, to reassess the bank/client relationship and carry-on necessary follow-up actions promptly.
- Classify the unpaid debt customers to make claims and provide necessary information to relevant parties, if warranted</td></tr>
</table>

Module 1 - UoC 109319L5 - Develop internal policies, guidelines, and standards for different operations to comply with regulatory requirements. (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Demonstrate professional knowledge in banking law in order to identify the requirements of different regulations. - Prosses knowledge in rules and regulations related to banking operations (e.g., framework issued by Basel Committee on Banking Supervision and requirements of HKMA Supervisory Policy Manual, etc.) and apply it to evaluate the relevant regulations and identify the effects on the bank's policies, procedures, and operation as appropriate
2	Applications	Be able to - Evaluate the business/operations of the bank in order to assess whether they can fulfill the regulatory requirements. - Review the existing level of compliance risks and identify possible scenarios of breaches of law in order to formulate control measures. - Review the probability and possible consequences of non-compliance when designing the control measures. - Develop the scope and objective of internal standards based on the review findings. - Specify the handling methods of dealing with different scenarios of non-compliance based on the estimated consequences and impacts to the bank. - Design effective internal reporting systems to provide management with updated information on compliance
3	Professional Behavioural and Attitude	Be able to - Formulate internal standards by stating practices acceptable/required by the bank and ensure the standards set are in proportionate with the level of risk exposure. - Propose internal compliance policies, guidelines and standards which can maintain a proper balance between compliance with statutory requirements and operational efficiency. - Take actions to ensure existing framework is adequate to safeguard the bank from regulatory risks

Module 2 - UoC 109256L5 - Review risk assessment on credit application (Level 5 with 4 credits)

<table>
<tr><th colspan="3">Performance Requirements /ILO</th></tr>
<tr><td>1</td><td>Knowledge</td><td>Be able to
- Demonstrate expert knowledge in theories and concepts across different areas of corporate finance in order to assess the risks of loan application
- Understand the characteristics of different credit products offered by the bank and apply the knowledge to compare and contrast features of them in order to judge the suitability of loan applicants.
- Possess knowledge on the bank's business portfolio and conduct research on factors affecting default risks and assess the probability and impacts of default</td></tr>
<tr><td>2</td><td>Applications</td><td>Be able to
- Interpret research findings or other information on macroeconomic environment and industry analysis in order to assess business outlook and possible risks of the applicants' business
- Evaluate financial statements and identify incomplete information in order to have an accurate and comprehensive analysis on the financial standing of borrower (need for securities)
- Evaluate liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations in order to identify discrepancies or suspicious statements/reports.
- Evaluate and select the most suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of the businesses or projects
- Conduct site visit to verify the authenticity of information submitted and obtain additional information for assessment
- Conduct credit risk assessment by evaluating the business risk, financial risk, and total corporate risk of the businesses/projects in consideration
- Estimate the degree of risk involved in extending credit or lending money by consolidating</td></tr>
<tr><td>3</td><td>Professional Behavioural and Attitude</td><td>Be able to
- Make recommendations on whether the current assessment methods satisfy the changing lending criteria of the banks
- Recommend revised assessment criteria and approaches for determination of approval (with or without condition(s))/rejection on loan application and approved loan size with justification provided
- Specify revised principles for justification of approval on application which are violating credit risk policies or general lending criteria</td></tr>
</table>

Module 2 - UoC 109257L5 - Structure the credit facility (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Comprehend the theories and concepts related to corporate credit management in order to assess the risks of loan application - Demonstrate professional knowledge in corporate loan financing by applying it to evaluate factors affecting default risks ad assess the impact on loan applications - Possess knowledge in different enterprise banking loan products of the bank and apply it to evaluate and compare the features of them in order to judge the suitability of loan applicants
2	Applications	Be able to - Identify clients' purposes and objectives for the loan by evaluating relevant information - Interpret and analyse financial information submitted (e.g., financial statements) to determine financial standing of applicants - Conduct financial analysis on the business such as income growth, quality competence of management and market share to determine expected profitability of the business thus the repayment abilities of applicants - Perform assessment on the specific projects or assets which require financing, analyse cash flow to be generated and valuation of assets in order to have a more accurate assessment on the risks involved - Develop tailor-made financial package options for applicants and structure the T&C (e.g., loan amount, repayment timeline, rates, etc.) based on earnings, repayment history, prospective risk level, etc. - Develop loan repayment plan (e.g., when how and provide supporting information to substantiate the plan (e.g. projected cash flow, projected revenue) - Develop proposals to specify financing options available to applicants and present the terms and explanation in a clear manner
3	Professional Behavioural and Attitude	Be able o - Determine pricing of individual credits to ensure the returns are commensurate with the risk level - Analyse the risks of repayment and select suitable collateral or guarantee to protect the bank in case of inability to pay

Module 2 - UoC 109260L5 - Assess credit and financial strength of borrowers and prepare credit proposal (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Familiarize with special knowledge related to corporate finance in order to assess the risks of loan application - Have in-depth understanding of credit management in order to identify factors which might affect default risks and assess the impact on loan applications - Understand liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations
2	Application	Be able to - Interprets research findings on macroeconomic environment and industry analysis in order to understand the business outlook of the applicants' businesses - Interpret financial statements to determine financial standing of borrower - Apply suitable methods (e.g., net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of businesses or projects - Conduct site visit to verify the authenticity of documentation submitted and obtain additional information for assessment - Conduct preliminary credit risk assessment by evaluating the business risk, financial risk, and total corporate risk of the businesses/projects in consideration - Provide recommendations regarding the degree of risk involved in extending credit or lending money by consolidating information from different analysis e.g., track record, business performance, collateral valuation) - Calculate the cost of offering the loan e.g., funding costs, overhead expenses, administrative costs - Calculate amount to be allocated to loan loss reserve and capital charges based on default probability, loss levels, etc. - Provide recommendations regarding the affordability to enterprise clients and propose long-term, mid-term and short-term financing solutions - Compute clients' ability to repay loan, estimate time for debt repayment given amount of debt, interest rates, and available funds
3	Professional Behavioural and Attitude	3. Behavioural and Attitude - Recommend approval (with or without conditions(s))/rejection on loan application and approved loan size with justification provided - Provide justification for approval on application violating credit risk policy or lending criteria

Module 2 - UoC 109502L5 - Conduct company financial analysis to identify clients' needs (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Demonstrate in-depth knowledge on company's financial analysis by applying it to evaluate different common methodologies within the bank's framework in analyzing company performance and to develop a suitable approach for assessing the current banking facility application - Demonstrate professional knowledge in the client's industry, e.g. key terms and terminology, performance indicators for analysis, business cycle, competitive landscape, latest development, etc. in order to identify focus and scope of company analysis
2	Applications	Be able to - Identify information useful for understanding the business and employ different approaches to obtain the relevant information for account planning purposes (e.g., send request to clients, industry practitioners, etc.) - Consolidate relevant financial data and evaluate financial position of client by analyzing financial statements, business contracts, ageing reports, etc. - Analyse the strategic direction and major business initiatives to identify the future potential, challenges, and opportunities of the company - Evaluate the business models and identify factors that may impose significant effect on their earnings and cost structures hence to predict the prospect of the business - Assess the risk of potential financial loss that doing business with the client, ultimately determining whether to offer the credit facilities
3	Professional Behavioural and Attitude	Be able to - Identify key forces shaping the industry of the clients' businesses and learn from the accuracy of historical forecasts to make adjustments to the assessment methods - Analyse the value chain of the business and adopt a holistic consideration to assess opportunities and risks associated with the client's operations - Compare the performance, business model and operations of the clients with companies of similar size in the same industry hence to produce a fair judgement

Module 3 - UoC 109257L5 – Structure the credit facility (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Comprehend the theories and concepts related to corporate credit management in order to assess the risks of loan application; - Demonstrate professional knowledge in corporate loan financing by applying it to evaluate factors affecting default risks and assess the impact on loan applications; - Possess knowledge in different enterprise banking loan products of the bank and apply it to evaluate and compare the features of them in order to judge the suitability of loan applicants.
2	Application	Be able to - Identify client's purposes and objectives for the loan by evaluating relevant information; - Interpret and analyse financial information submitted (e.g. financial statements) to determine financial standing of applicants; - Conduct financial analysis on the business such as income growth, quality/competence of management and market share to determine expected profitability of the business thus the repayment abilities of applicants; - Perform assessment on the specific projects or assets which require financing, analyse cash flow to be generated and valuation of assets in order to have a more accurate assessment on the risks involved; - Develop tailor-made financial package options for applicants and structure the terms and conditions (e.g. loan amount, repayment timeline, rates, etc.) based on earnings, repayment history, prospective risk level, etc; - Develop loan repayment plan (e.g. when, how) and provide supporting information to substantiate the plan (e.g. projected cash flow, projected revenue); - Develop proposals to specify financing options available to applicants and present the terms and explanation in a clear manner
3	Professional Behavioural and Attitude	Be able to - Determine pricing of individual credits to ensure the returns are commensurate with the risk level; - Analyse the risks of repayment and select suitable collateral or guarantee to protect the bank in case of inability to repay.

Module 3 - UoC 109258L5 – Evaluate the performance of credit acquisition and make suggestions (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Understand the technical knowhow of credit acquisition and apply the knowledge to evaluate the formula in calculating revenue to ensure the existing approach can provide an accurate and comprehensive calculation; - Understand the key factors which might affect the revenue from credit acquisition and apply the knowledge to execute a fair and unbiased evaluation on the performance of the bank's credit business.
2	Application	Be able to - Evaluate the performance of credit business and identify factors affecting the performance; - Estimate cost and revenue associated with different credit acquisition; - Compare the results with the performance in other time periods and conclude on the effectiveness and profitability of the credit business after considering the business and economic situations; - Analyse the hit rate on credit acquisition and calculate the success rate on different types of business (e.g. credit products, clients' segments); - Analyse failed cases in credit acquisition and conduct relevant analysis (e.g. competitor analysis) to identify the causes.
3	Professional Behaviour and attitude	Be able to - Evaluate different approaches for pricing and select the most optimal one after analysing the performance of credit business; - Conduct pricing comparison with other banks so as to recommend a competitive offer; - Determine the optimal levels of and standards for credit limits, risk cut-offs, collection actions to balance profitability and risk; - Develop alternatives to balance income potential with sufficient credit loss reserve levels.

Module 3 - UoC 109259L5 – Provide consultancy service to clients on credit risk (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Understand different theories and concepts related to credit analysis in order to assess the suitability of loan products offered to different clients; - Possess professional knowledge in credit analysis and different credit products and apply it to provide suitable advice to enterprise banking clients;
2	Application	Be able to - Analyse risks associated with the products or services requested by the clients and assess the suitability; - Assess the knowledge of the clients in order to evaluate their understanding on the risks inherited in the products or services - Identify customers' needs on consultancy service related to credit risk based on their business model, knowledge on the products acquired, etc.; - Explain features and risk levels of different alternatives and use appropriate methods to ensure clients have an accurate understanding.
3	Professional Behavioural and attitude	Be able to - Provide customized consultancy service on credit risks in accordance with the financial situation and risk bearing ability of each enterprise client; - Evaluate the situation of clients and provide advice on the suitable alternatives on investment/ settlement methods in accordance with their unique financial situation and needs.

Module 3 - UoC 109260L5 – Assess credit and financial strength of borrowers and prepare credit proposal (Level 5 with 4 credits)

<table>
<tr><th colspan="3">Performance Requirements /ILO</th></tr>
<tr><td>1</td><td>Knowledge</td><td>Be able to
- Familiarize with specialized knowledge related to corporate finance in order to assess the risks of loan application;
- Have an in-depth understanding of credit management in order to identify factors which might affect default risks and assess the impact on loan applications;
- Understand liquidity, profitability, and credit histories of establishments being evaluated with those of similar establishments in the same industries and geographical locations.</td></tr>
<tr><td>2</td><td>Application</td><td>Be able to
- Interpret research findings on macroeconomic environment and industry analysis in order to understand the business outlook of the applicants' businesses;
- Interpret financial statements to determine financial standing of borrower;
- Apply suitable methods (e.g. net present value based on present market values, discounted cash flow valuation, etc.) to calculate the value of businesses or projects;
- Conduct site visit to verify the authenticity of documentation submitted and obtain additional information for assessment;
- Conduct preliminary credit risk assessment by evaluating the business risk, financial risk and total corporate risk of the businesses/projects in consideration;
- Provide recommendations regarding the degree of risk involved in extending credit or lending money by consolidating information from different analyses (e.g. track record, business performance, collateral valuation);
- Calculate the cost of offering the loan, e.g. funding costs overhead expenses, administrative costs;
- Calculate amount to be allocated to loan loss reserve and capital charges based on default probability, loss levels, etc;
- Provide recommendations regarding the affordability to enterprise clients and propose long-term, mid-term and short-term financing solutions;
- Compute clients' ability to repay loan, estimate time for debt repayment given amount of debt, interest rates, and available funds.</td></tr>
<tr><td>3</td><td>Professional Behavioural and Attitude</td><td>Be able to
- Recommend approval (with or without condition(s))/rejection on loan application and approved loan size with justification provided;
- Provide justification for approval on application violating credit risk policy or lending criteria.</td></tr>
</table>

Module 3 - UoC 109269L5 – Evaluate market value and marketability of collateral and identify the risks associated with the loan (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Demonstrate professional knowledge on the bank's policies about different types of well-defined acceptable collateral and their respective security value in accordance with internal guidelines; - Possess specialized skills on asset valuation and apply them to evaluate common practices in banking industry in order to refine existing approach adopted by the bank.
2	Application	Be able to - Identify factors which can affect the market value of different kinds of assets to ensure an accurate valuation - Analyze market situations and valuation done by other banks in order to evaluate the formula of assets valuation adopted by the bank - Analyse information on trends in historical price, future economic development and other relevant factors in order to determine the fair market value of different collaterals; - Evaluate changes in the value of collaterals and adjust risks associated with the loan accordingly;
3	Professional Behaviour and attitude	Be able to - Initiate the loan review process to evaluate whether adjustment is necessary; - Always benchmark and follow the best practices to execute asset valuation.

Module 3 - UoC 109293L5 – Structure credit facilities for large scale operating assets financing programmes (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Demonstrate comprehensive and specialized knowledge in credit management in order to structure financing programmes on operating assets; - Possess professional knowledge regarding the industry specialization (e.g. sector structure, key competitors, critical success factors) of the clients in order to evaluate the risks and profitability of the deal; - Demonstrate professional knowledge in operating assets finance by applying it to assess the values of clients' operating assets and inventory to justify loan approval.
2	Application	Be able to - Evaluate the performance of clients' business by employing different qualitative and quantitative methods (e.g. accounting ration, cash flow analysis); - Assess the risks of applications and evaluate the business strategies of the company in order to assess the needs in asset investment and the commercial value of the operating assets; - Analyse the capital structure of clients in order to identify the most suitable means of financing which can balance their assets and liabilities portfolio.
3	Professional Behavioural and Attitude	Be able to - Structure the deals in accordance with the credit worthiness of the clients, values of the operating assets, projected performance of the business and credit strategies of the bank; - Analyse the debt structure of the clients to structure a deal which can meet the financial needs of clients while provide adequate protection to the bank's interests.

Module 3 - UoC 109502L5 – Conduct company financial analysis to identify clients' needs (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Demonstrate in-depth knowledge on company financial analysis by applying it to evaluate different common methodologies within the bank's framework in analysing company performance and to develop a suitable approach for assessing the current banking facility application. - Demonstrate professional knowledge in the clients' industry, e.g. key terms and terminology, performance indicators for analysis, business cycle, competitive landscape, latest development, etc. in order to identify focus and scope of company analysis.
2	Application	Be able to - Identify information useful for understanding the businesses and employ different approaches to obtain the relevant information for account planning purpose (e.g. send request to clients, industry practitioners, etc.) - Consolidate relevant financial data and evaluate financial position of client by analysing financial statements, business contracts, ageing reports and, etc., - Analyse the strategic direction and major business initiatives to identify the future potential, challenges and opportunities of the company; - Evaluate the business models and identify factors that may impose significant effects on their earnings and cost structures hence to predict the prospect of the business; - Assess the risk of potential financial loss that doing business with the client, ultimately determining whether to offer the credit facilities.
3	Professional Behaviour and attitude	Be able to - Identify key forces shaping the industry of the clients' businesses and learn from the accuracy of historical forecasts to make adjustments to the assessment methods; - Analyse the value chain of the business and adopt a holistic consideration to assess opportunities and risks associated with the client's operations; - Compare the performance, business model and operations of the clients with companies of similar size in the same industry hence to produce a fair judgement.

Module 3 - UoC 109503L5 – Present financial solutions to general enterprise banking clients (Level 5 with 4 credits)

Performance Requirements/ILO		
1	Knowledge	Be able to - Demonstrate professional communication and presentation skills in order to communicate the proposal clearly; - Possess the product knowledge and knowledge on the client and be able to highlight key factors that can exert influence on client's decision in the presentation.
2	Application	Be able to - Match appropriate banking products with customer needs in order to offer the best solutions for clients and describe the details of the proposal (e.g. terms and conditions) in an accurate manner; - Evaluate the business negotiation continuously and make appropriate changes in sales approach in order to increase the odds of success; - Communicate risks to customers in accordance with sales compliance and check client's understanding of clients; - Manage the expectations of clients in order to preserve a long-term harmonious relationship with them.
3	Professional Behaviour and Attitude	Be able to - Make enough preparation to forecast possible enquiries or objections from clients and get proper answers ready in advance; - Handle the inquiries from clients professionally to address technical issues in order to close the deals with client satisfaction; - Be client focused by paying attention to prospects buying signals and gain their commitment at appropriate time by using suitable closing techniques

Module 3 - UoC 109504L5 – Negotiate with the clients to finalize the customized financial solutions (Level 5 with 4 credits)

Performance Requirements /ILO		
1	Knowledge	Be able to - Demonstrate professional knowledge in business negotiation by evaluating different negotiation strategies and theories in consumer psychology and applying them aptly according to the situations - Demonstrate professional knowledge in corporate and commercial lending to assess the counter offers proposed by clients
2	Applications	Be able to - Assess the bottom line of prospects (i.e. must have, should have, nice to have) in order to propose a compromise solution; - Determine the bottom line of the bank and develop different concessions alternatives with an attempt to maximize the bank's outcomes; - Evaluate the position of the bank and client by estimating the risks exposure faced by the bank and evaluating against its risk tolerance ability when restructuring the position; - Anticipate the potential concerns and objections of the prospects in order to develop possible counter-solutions to pre-empt their concerns.
3	Professional Behavioural and Attitude	Be able to - Be client focused and identify the negotiation styles of prospects to adapt to their styles while planning the negotiation strategies - Address actual client needs during negotiation and employ influencing and persuasive skills to provide compelling reasons to facilitate the decision-making process of clients; - Be well prepared in coordination with different technical specialists to restructure the proposal according to clients' needs, if necessary; - Determine when to withdraw from the negotiation if a feasible/profitable deal cannot be achieved and conduct the closure professionally and tactically.

Appendix 2 – List of Suggested Self-Study Books

Note to Trainers

Trainers may select the books for the learners' pre-class reading.

Suggested Internet Links for Reading Materials	Modules =M Submodules = S									
	M1					M2			M3	
	S1	S2	S3	S4	S5	S1	S2	S3	S1	S2
Baesens Bart, Scheule Harald, Rosch Daniel, Credit Risk Analytics: Measurement Techniques, and Examples in SAS (Wiley and SAS Business Series), 1st Edition, 2016		X	X	X						
Bouteille Sylvain, Coogan Diana, The Handbook of Credit Risk Management: Originating, Assessing, and Managing Credit Exposures (Wiley Finance), 2nd Edition, 2022	X	X	X	X	X	X	X	X		
Edward Bodmer, Corporate and Project Finance Modeling: Theory and Practice, (Wiley Finance) 1st Edition, 2015								X	X	
Ganguin Blaise, Bilardello John, Standard & Poor's Fundamentals of Corporate Credit Analysis (McGraw-Hill), 2005						X	X	X		
Howard Schilit, Jeremy Perler, Yoni Engelhart, Financial Shenanigans: How to detect accounting gimmicks and fraud in financial reports (McGrawhill Education), 4th edition, 2018 (search also for video on CFAinstitute.org)						X	X	X		
Jorion Philippe, Financial Risk Manager Handbook: FRM Part I/Part II (GARP), 2011 (Part six)		X	X							
Joseph Ciby, Advanced Credit Risk Analysis and Management (Wiley Finance), 1st Edition, 2013 (Part three, four, five)						X	X	X	X	
Stephenson Harwood, Shipping Finance, A Practical Handbook, Fourth Edition, Global Law and Business, 2018									X	
Stephen A. Jones, Trade and receivable finance, Palgrave macmillan, 2018									X	
The LSTA's Complete Credit Agreement Guide, Michael, Bellucci and Jerome McCluskey, Milbank, 2017, McGraw Hill Education									X	
Simon Thompson, Green and Sustainable Finance, Principles and Practice in Banking, Investment and Insurance, Chartered Banker, Kogan Page, 2023									X	

Appendix 3 – List of Suggested Optional Reading Materials

Note to Trainers

Trainers may select the books for the learners' pre-class reading.

Suggested Internet Links for Reading Materials	Modules =M Submodules = S									
	M1					M2			M3	
	S1	S2	S3	S4	S5	S1	S2	S3	S1	S2
CA-G-4 Validating Risk Rating Systems under the IRB Approach, Supervisory Policy Manual, HKMA, CA-G-4 (hkma.gov.hk)	X	X						X		
Stress Testing Loan Portfolio in Terms of Crisis, Stress testing loan portfolios in times of crisis (assets.kpmg)	X	X	X	X						
The role of stress testing in credit risk management, Roger M. Stein, Moody's Research Labs NY, Jun 15, 2011, 11-15-06-The-role-of-stress-testing-in-credit-risk-management.pdf (moodysanalytics.com)	X	X	X	X						
Stress Testing the Commercial Loan Portfolio: Why and How (rmau.org) Banking Crisis (worldbank.org)	X	X	X	X						
A framework for macro stress testing the credit risk of banks in Hong Kong, Jim Wong, Ka-Fai Choi, and Tom Fong , HKIMR, Hong Kong Monetary Authority Quarterly Bulletin, December 2006 (6N095E_F_25_38-p65 (hkma.gov.hk))	X	X	X	X						
Portfolio Stress Testing, MPI Research, September 29, 2018, Portfolio Stress Testing | Markov Processes International	X	X	X	X						
The 1997-98 Korean Financial Crisis: Causes, Policy Response, and Lessons; Presentation by Kim Kihwan at the IMF-Singapore Government High level seminar, Singapore; July 10, 2006	X	X	X	X						
A framework to monitor vulnerabilities and resilience of EMEAP economies, HKMA, May 24, 2022, A framework to monitor vulnerabilities and resilience of EMEAP economies (hkma.gov.hk)			X							
Implications of Loan Portfolio Concentration for Credit Risk of Banks in Hong Kong (hkma.gov.hk)			X							
An overview of the issues and a synopsis of the results from the Research Task Force project, Studies on credit risk concentration: an overview of the issues and a synopsis of the results from the Research Task Force project - November 2006 (bis.org)			X							
Hong Kong Monetary Authority - Exposure Limits (hkma.gov.hk)			X							

Suggested Internet Links for Reading Materials	Modules =M Submodules = S									
	M1					M2			M3	
	S1	S2	S3	S4	S5	S1	S2	S3	S1	S2
						X	X	X		
Corporate Credit Risk Premia, Review of Finance, Volume 22, Issue 2, Berndt, Douglas,						X	X	X		
Duffie and Ferguson, 27 January 2018, Price of bearing credit risk about expected loss https://academic.oup.com/rof/article/22/2/419/4828075								X		
Small & Medium Enterprise (SME) Financing: Measuring Private Firm Credit Quality, Moody's Analytics: (2013-03-09-sme-financing-measuring-private-firm-credit-quality.pdf (moodysanalytics.com))								X		
Alternative Credit Scoring of MSMEs, HKMA, November 2020, Alternative Credit Scoring of Micro-, Small and Medium-sized Enterprises (hkma.gov.hk)								X		
The Sharing and Use of Commercial Credit Data through a Commercial Credit Reference Agency, HKMA, Dec 30, 2022, The Sharing and Use of Commercial Credit Data through a Commercial Credit Reference Agency (hkma.gov.hk)								X		
New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments, OECD, 2015, New-Approaches-SME-full-report.pdf (oecd.org)								X		
The Banking Sector Sets Up a Coordination Mechanism to Support Small and Medium-Sized Enterprises (SME), Press Release, 16 Oct 2019, HKMA, Hong Kong Monetary Authority - The banking sector sets up a coordination mechanism to support small and medium-sized enterprises (SMEs) (hkma.gov.hk)								X		
Second meeting of the Banking Sector Coordination Mechanism to Support Small and Medium-Sized Enterprises (SME), Press releases, 20 Jan 2020, HKMA Hong Kong Monetary Authority - Second meeting of the Banking Sector Coordination Mechanism to support small and medium-sized enterprises (SMEs) (hkma.gov.hk)								X		
Cross-border Lending – What Offshore Lenders Need to Know, King and Wood Mallesons, 2022, Cross-border Lending - What Offshore Lenders Need To Know - KWM								X		

Suggested Internet Links for Reading Materials	Modules =M Submodules = S									
	M1					M2			M3	
	S1	S2	S3	S4	S5	S1	S2	S3	S1	S2
Basel III and the Future of Project Finance Funding, Tianze Ma, University of Michigan Law School, Michigan Business & Entrepreneurial Law Review, Volume 6, Issue 1, 2016. Basel III and the Future of Project Finance Funding (umich.edu)									X	
Project Finance in Hong Kong: Overview, Barry Cheng and Kim Hock Ang, Baker Mckenzie, 1 April 2018, Project finance in Hong Kong: overview | Practical Law (thomsonreuters.com)									X	
Modeling Aircraft Loan & Lease Portfolio (3rd revision), Discussion Notes, October 2015, PK AirFinance, sub-business of GE Capital Aviation Services, Risk & Reward in Aircraft Backed Finance (gecapital.com)									X	
Aviation Debt Update on Debt Financing for Airlines and Aircraft Lessors, Discussion Paper by John Caslin, 18 February 2021, Banking and Aviation Finance Sub-Committee of the Society of Actuaries in Ireland, 20210218_Aviation Briefing Note.pdf (actuaries.ie)									X	
Aviation Leaders Report 2023, Aviation Finance, 16 January 2023, Aviation Finance - The Cost of Capital - KPMG Ireland									X	
Corporate Loan Pricing and Collateral Decision in Hong Kong: Evidence from Granular Transaction-level data, Muyang Wu and Zijun Liu, 4 May 2020, HKMA Corporate Loan Pricing and Collateral Decision in Hong Kong (hkma.gov.hk)									X	
Why Metals Keep Going Missing in Commodity Trading: QuickTake - Bloomberg									X	
Negotiation Theory and Practice, A Review of Literature, Tanya Alfredson, Azeta Cungu', 2008, Negotiation Theory and Practice: A Review of the Literature (fao.org)										X
Negotiations and Resolving Conflicts: An Overview, Professor E. Wertheim, College of Business Administration, Northeastern University, Negotiation Skills.pdf (europarc.org)										X
Modernizing corporate loan operations, McKinsey & Company, Jan 25, 2024, Modernizing corporate-loan operations | McKinsey			X							

Appendix 4 – Sample - Simulation Case (1)

Case Sample

Early Warning Signals

It was history: Lehman Brothers' (L Co) stock price vaporized by 93% **on September 12, 2008**. The same day, it declared bankruptcy which ended a legend since 1844. In the next chaotic months, Governments injected trillions of dollars to prevent the world bank system from collapsing.

Only one year before, in 2007, L Co continued to underwrite mortgage securities ambitiously, as in the previous five years, to reach an $85 billion portfolio or four times its shareholders' equity. It topped the market with that aggressive portfolio cumulation. On the other side of the same stage, there were insurers with relatively new insurance products to insure trillions of dollars of mortgage securities.

Before that, in 2003 and 2004, the markets knew that the U.S. housing bubble was well underway. However, sub-prime mortgage schemes kept attracting more buyers into the property market. So, in those days, L Co acquired five mortgage lenders specialized in Alt-A class mortgages with risk profiles between prime and subprime.

Situation

Your direct supervisor asked you to construct an executive report which serves as a pretext to review your bank's practices, methods, and disciplines regarding timely identification and response to early warning signals. It helps if you refer to the above Company's failure for issues, root causes, insight, and lessons learned. In addition, the executive report should contain a summary of facts, discussions, and recommendations to the bank.

Note to learners: Refer to Case Appendix 6 for the template of the executive report. You are to demonstrate competency in knowledge, skills, and behaviours by articulating past lessons learned to the current situation and coming up with recommendations commensurate with the bank's size and scale.

Note to learners: Please organize response of questions in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and to evaluate real-life applications supported by examples.

Case Appendix 1

Explanation of the Case

Case Objective

With this post-class learning activity, the learners will create self-revealing moments in the areas requiring more in-depth exploration of knowledge and skills.

Case

The information given in this document provides the basis of the real situation, such as the business or the product, the internal and external market environment. However, they are meant to serve as food for thought, rather than serving as a complete set of contextual information, for the learners to start preparing the executive report. The learners are to conduct supplementary research to balance and to complete their discussions in the executive report.

Case Appendix 2

Food for Thought

Note to the trainers

This section provides food for thought to warm a learner before writing the executive report. It also provides directions for the learner to research further the L Co"s issues, which will help to gather relevant information for the discussions in the executive report to lead to a recommendation to the Bank.

(1) According to the interview report, Madelyn Antoncic was the chief risk officer at L Co between 2002 and 2007. She joined L Co in 1999 and found herself "in an institution that didn't have much appetite for risk management." [110] Antoncic created a risk framework with a risk model and people on board to perform live risk management.

Food for thought

Think through the issues and insights generated regarding the immediate causes of L Co's failure, and the associated risk factors that it should have addressed as early as possible.

(2) According to the Congress document "The Causes and Effects of the Lehman Brothers Bankruptcy," which recorded the hearing before the U.S. Committee on Oversight and Government Reform on October 6, 2008, L Co saw warning signs but did not move early/fast enough and lacked discipline about capital allocation.

Food for thought

Reflect and discuss on the root causes of L Co's procrastination in response despite the obvious risk level changes and the warning signals generated from the credit risk management system.

(3) External risks require close monitoring to identify early warning signals. According to the Congress document above, there are three main contributors to the 2008 financial meltdown:

- An easy credit environment
- Mortgage-backed securities sold to institutional investors.
- An increase in leverage

The problem came when the U.S. housing sector reached saturation, compounded by other economic situation changes.

Food for thought

Understand the external environment during the financial crisis in 2008 to think about the best practices for identifying early warning signals of the external environment and making recommendations to the Bank, within context, on best practices, monitoring methods, and disciplines to ensure unbiased judgment.

[110] Not Too Big To Fail: Why Lehman Had to Go Bankrupt - Knowledge at Wharton (upenn.edu)

Case Appendix 3

Timeline

Note to trainers
This section contains some information and data about the case situation. Learners may include additional information and data from further research, where applicable, for the discussions in the executive report.

The list below indicates the timelines of the market and L Co in the months of the meltdown.

Timeline: March 9 – 15, 2008

It was chaotic. Banks deep in crisis updated about the tens of billions of dollars lost. Fund companies encountered a liquidity crisis and could not repay their debts. Global banks paid out billions to bail out hedge funds in trouble. Many Walls Street's reputable names are involved.

Timeline: September 14 – 20, 2008

Stock price of the world's biggest insurance company plunged. It was the major player in the new credit default swap market to ensure leverage debt when the concerned portfolios melted down. Nobody could have imagined: the world's biggest insurance company failed.

Timeline: October 5 – 11, 2008

L Co went bankrupt; giant financial institutions failed or bailed out. The financiers and the politicians learned their life lessons, with many stories to tell until decades later. Indeed, some of them are still handling the shock waves rippling today.

Case Appendix 4

About Your Bank

<u>Note to trainers</u>

Learners will apply their bank's context to construct the executive report. However, for non-RP learners, the information below helps build a context for the executive report writing.

Background

The time is now. Your Bank is a medium-sized leading Hong Kong-based financial conglomerate with assets of HKD1,000 billion as of the end of the financial year.

Branch network

The Bank has branches in Hong Kong, China, the UK, and the USA. Unfortunately, the asset quality in China has deteriorated, and the management team has significantly prioritized asset quality improvement.

Financial performance

Profit before tax growth in the financial years comes mainly from fee and commission income and one-time gains. NIM stabilized in the financial year, but not the net interest, which continued to decrease. The economic growth in the local, China, and overseas markets varies from contraction, deteriorating, and pessimistic. As a result, some corporate clients continue to face revenue turmoil. However, corporate banking's performance has improved over the past years.

Business strategy

The Bank continually looks for opportunities in geographic areas with a more robust economic recovery. Also, it constantly focuses on the improvement of asset qualities.

Risk management

The Bank's overall risk appetite guides its business plan. As a result, the return on assets from businesses aligns with the planned risk level, strategic goals, business outlooks, and risk management policies.

Digital transformation

The Bank continually implements its digital transformation plan in the last decade. For example, it has embedded various interactive digital devices at branches to enable real-time remote service support.

Organizational culture program

The Bank has launched a corporate digital transformational program for a decade to increase all employees' awareness and receptiveness to digital transformation. A positive attitude toward technology deployment and mainframe system enhancement facilitates the efficient handling of critical processes.

The Bank has launched parallelly a corporate credit risk culture educational program to increase all employees' awareness of credit risk management being the responsibility of everyone.

Financial positions

Portfolio growth versus prior year	
Customer Loans	+8%
Customer Deposit	+9%
Customer Deposit & CD	+8%

Key ratios as of year end	
Loan to deposit	80%
Total capital ratio	22%
Tier I capital ratio	20%
Common Equity	18%
Liquidity Coverage	175%

Case Appendix 5

Reference

<u>Note to trainers</u>
Major information sources report follow-ups of significant credit cases. Therefore, continual updates of the reference will highlight the latest market trends or updates related to the case topics, helping to broaden a learner's views for putting up recommendations in the executive report.

The Collapse of Lehman Brothers: A Case Study (investopedia.com)
Three weeks that changed the world | Banking | The Guardian
The Truth About Lehman Brothers and AIG | Time
Not Too Big To Fail: Why Lehman Had to Go Bankrupt - Knowledge at Wharton (upenn.edu)
- THE CAUSES AND EFFECTS OF THE LEHMAN BROTHERS BANKRUPTCY (govinfo.gov)
Hong Kong Monetary Authority - Norman Chan on Seven Lessons of the Global Financial Crisis (hkma.gov.hk)
Norman T L Chan: When markets fail (bis.org)

Case Appendix 6

Template – Executive Report

Note to learners
The template on the following pages shows the structure of the executive report. Please embed an executive summary, synthesis the given and researched information and data, and discuss the associated issues, root causes, and insights to support best practices (or defy non-practice), an aggregate of which leads to recommendations to the Bank to overcome the constraints in identification and response to early warning signals.

Upon completion of the report on or before the requested due date, send it by email to the trainer. The trainer will send the feedback to you.

Name	[Name of learner]
Module Number	[Module Number]
Submodule Number	[Sub module Number]
Email address	[Learner's email address]

Section I Executive summary (in about 300 words) *Articulate the relevance of L Co's case to your assigned tasks. Summarize the purpose of the executive report and its key points.*

Section II Summary information and data (in about 300 words) *Prepare a summary with the given information and data, as well as other researched information, to demonstrate your knowledge about the Bank's credit strategy and the external environment.*

Section IIIA Issues, immediate causes of failure and insight (in about 300 words)
L Co's stakeholders delayed reactions to early warning signals, which directly led it to the failure. Discuss the immediate sources and causes of the changes in risk level or system risk. Generate insight regarding the associated risk factors that it should have addressed as early as possible.

Section IIIB Discuss the procrastination of L Co's response to early warning signal (in about 300 words)
Discuss the root causes underlying the immediate causes of L Co's failure. Demonstrate professionalism by applying impartial and unbiased judgment regarding the association of the root causes to L Co's decision, leading to procrastination in response to the early warning signals.

Section IIIC Best practice, and methods (in about 300 words)
Pursual to Section IIIA and IIIB, discuss the principles for effective monitoring risk factors and recommend the best practices and methods to ensure identification of early warning signals. (Include but not limited to credit administration compliance, tracking risk indicators, review of the forecast, report to senior management on risk profile analysis, and others).

Section IV Constraints of the recommendations and potential solutions (in about 300 words) *Demonstrate professionalism by applying impartial and unbiased judgment with the discussion of the constraints of the recommendation in Section (IIIC) and suggest potential solutions to overcome. Also, include the required disciplines to ensure unbiased judgment and timely response to early warning signals.*

Section V Reference links *List all references deployed to complete the case report.*

Section VI Presentation Slides *Attach the presentation slides to highlight the key items of the executive report. Use the same slides for a 10 – 15 minutes presentation, if requested by the trainer, before the trainer's feedback.*

Sample

Executive Report

<u>Note to trainers</u>

This sample is for trainers' reference only

Name	Chan, Taiman
Module Number	Module 1
Submodule Number	Submodule 1
Email address	T.M.Chan20000707@gmail.com

Section I Executive Summary (in about 300 words)

Articulate the relevance of L Co's case to your assigned tasks. Summarize the purpose of the executive report and its key points.

Root Causes of The L Co's Failure

L Co's failure was the compounded outcome of its management's lack of timely actions toward risk signals, its misalignment of credit strategies and business objectives, and the continual macroeconomic stimulating policies supported with low-interest rates, which resulted in the property market bubbles that burst eventually. The economic downturn and the interest rate surge led to the collapse of market confidence and the financial crisis.

Relevance of the L Co's Experience to the Identification of and Response To early warning signals in present economic situation

There are more stringent rules and regulations since 2008 to monitor the banks' risk level changes. Authorities in multiple countries have invested massive efforts to reach a continual consensus on credit risk (and other risk) management principles and approaches. However, while the world is still recovering from the post-crisis of the 2008 financial meltdown, the COVID-19 pandemic triggered new series of economic pulse-stop.

Also, the outbreak of war between Ukraine and Russia when pandemic was near its end has brutally intervened in the global governments' resort to low-interest rates to sustain the post-pandemic economic recovery. The dramatic surge in energy prices leads to the expectation of hyperinflation, and the elevated yield curves jeopardize economic recoveries and create new worries about economic depressions hence property market melt-down. The prolonged pandemic measures in major Asian markets aggravate economic sectors' downturns and business failures in specific markets. Together with the property bubble burst in China, the market sentiment resembles that in 2008.

Learnings and Discussions

This executive report discusses the associated issues, root causes, and insights from L Co's learning to support best practices (or defy non-practice) and monitoring methods recommended to the Bank. It also discusses the constraints of the recommendations and the potential solutions to overcome them.

About the Executive Report

Since the content of the executive report serves as a pre-text for the Bank to review the Bank's practices, methods, and disciplines regarding timely identification and response to early warning signals, I have exercised competency and possibly available resources to analyze the L Co's failure and to discuss and to recommend the best practices, the monitoring methods, and the disciplines to ensure unbiased judgment.

This report consists of four sections:

I. Executive summary
II. Information and data
III. Discussion on lessons learned and recommendation

IV. Constraints of the recommendation and potential solution

Section II Summary information and data (in about 300 words) *Prepare a summary with the given information and data, as well as other researched information, to demonstrate your knowledge about the Bank's credit strategy and the external environment.*

The summary below extracts information from the case and other reliable external sources. Where information is not available, I make assumptions.

Bank Size and Scale

- a medium size bank[111] that has a robust cross-organizational credit risk culture
- exposed to economic cycles in Hong Kong, China, the UK, and the USA
- highly focused on asset quality improvement in the short term for long-term growth
- open-minded to technology investment
- strong credit risk culture

Assumption

Given this is a medium size local bank, it is assumed that the Bank has substantial exposure to clients with business in China.

Bank's Credit Risk Strategy

The Bank's overall risk appetite guides its business plan. As a result, the return on assets from businesses aligns with the planned risk level, strategic goals, business outlooks, and risk management policies.

Assumption

Credit risk appetite aligned with the Bank's risk appetite to guide the business plan.

Credit Risk Management Resources for Credit Risk Management

The Bank's credit strategies guide its business direction

Assumption

At par with the market, the Bank has RP team of a broad spectrum from the most experienced to the less experienced, with a similar turnover rate. Also, The Bank has an open attitude about additional investment in credit risk management since it has significantly prioritized asset quality improvement

The Economic Outlooks

Researched information – China's economy[112]

- Industrial output grows slower than expected
- Retail sales fall
- Property investment sees the biggest drop since early 2020
- Economic outlook gloomy on softening external demand

Researched information – Hong Kong economy [113]

- Full-year economic forecast has negative growth
- Underlying inflation estimate remained at 2%

Researched information – UK economy[114]

- Expected decrease of 0.4%
- Inflation remains high
- Companies put investment on hold
- Gloomy implications for long-term growth

Researched information – USA economy[115]

- IMF cuts U.S. growth forecast to 2.3%
- Consumer spending cools off

[111] Hong Kong Banking Report 2022 (assets.kpmg)
[112] China's economy loses momentum as COVID curbs hit factories, consumers | Reuters
[113] Hong Kong's steep slide shows misplaced priorities | Reuters
[114] UK economy to shrink in 2023, risks 'lost decade': CBI | Reuters
[115] IMF again cuts U.S. 2022 growth forecast to 2.3% as consumer spending cools | Reuters

Section IIIA Issues, immediate causes of failure and insight (in about 300 words)

L Co's stakeholders delayed reactions to early warning signals, which directly led it to the failure. Discuss the immediate sources and causes of the changes in risk level or system risk. Generate insight regarding the associated risk factors that it should have addressed as early as possible.

L Co's stakeholders should have reacted promptly to the early warning signals of external risk level changes. Unfortunately, because of the delayed response, external risk changes finally eroded the values of L Co's assets to a detrimental extent.

Discussion: Immediate Causes Leading to L Co's Failure

L Co's failure depicts that prolonged changing external risks, however mild and insignificant at the beginning, might significantly impact the asset values. Immediate causes of L Co's credit risk level change are:

- Asset valuation - The property bubbles burst, and the valuation of the firm's mortgage-based assets reduced so quickly that L Co lost confidence in the market.
- Liquidity crunch - Reduction in asset values triggered overselling of assets. Counterparties reduce their credit exposures promptly; hence L Co could not roll over its debt to access necessary liquidity.
- Confidence free-fall - Free fall of market confidence. The market believed that L Co was too big to fail, but the expected government-assisted recovery never did realize

Insight: Associated Risk Factors Which Should Have Been Addressed as Early as Possible

Lessons learned also shed light on the fact that both external and internal risk factors can be crucial to asset quality level change.

- External risk (macro-economy)

The external risk factors lead to the "systematic risks" that impact on macro-economy and, ultimately, the credit market. Examples:

- Geo-political situation
- Commodity prices, e.g., crude oil
- Inflation
- Stock market significant movement
- Property market corrections

- External risk (industrial)

For industries with significant contributions to economic growth, the related risk factors impact the credit market. Examples are

- Industry-specific risk (e.g., the mortgage market continuously attracted increasingly sub-prime quality borrowers to go into the property market)
- Industry profit drivers (e.g., continuous low-interest rate environment encourages easy credit policy toward the sub-prime quality borrowers)
- Industry life cycle (e.g., the market demand by prime quality customers for mortgage loans saturated at some point in time, pushing downward the quality of the potential mortgage customers)

- Internal (Entity) risk

- According to the document of "The Causes and Effects of the Lehman Brothers Bankruptcy," the management has a significant role to play in an entity's crisis:

-Imbalanced incentive program for the entire management team
-Imbalanced incentive program for an ultimate revenue generator
-Weak finance function
-Weak compliance function
-Inadequate risk management function, e.g.,
o Lack of risk management personnel
o Lack of risk management infrastructure
-Top management's accountability culture

Section IIIB Discuss the root causes of L Co's failure to react to early warning signal (in about 300 words)

Discuss the root causes underlying the immediate causes of L Co's failure. Demonstrate professionalism by applying impartial and unbiased judgment regarding the association of the root causes to L Co's decision, leading to procrastination in response to the early warning signals.

It's recorded in the hearing of L Co that "… did turn a blind eye to clear warnings of impending danger sounded as early as 1998. As a result, they missed golden opportunities to treat localized problems before they dispersed throughout the economic system. "

The list below shows the root causes underlying L Co's failure and reflection on the procrastination of responses to warning signals:

- Product understanding: the financial institutions had issued mortgage securities with minimal disclosures, and the financial products covering the credit default risk were relatively new by then. The stakeholders should have a thorough comprehension of the impact of external risk factors on the risk level of the portfolios.

  Reflection on the management's judgment
  If the management has a thorough understanding of the impact of the external risk on the business owing to the risk features of the concentrated portfolio, it is likely to be more responsive to early warning signals.

- Misalignment of credit risk strategy and business plan: despite the Risk Officer's established risk management framework, putting up people to monitor the risk and providing early warning signals, the business strategies grew ambitiously in the concerned portfolio.

  Reflection on the management's judgment
  If the compensation package of the top management and top sales are highly correlated with immediate and short-term business performance, delaying the actions to mitigate risk is tempting.

- The worst might not be the worst: L Co did have a credit risk management framework and dedicated employees to perform risk management functions.

  Reflection on the management's judgment
  The worst scenario assumptions in the credit risk models undermined the worst market realities. If the risk model parameters had incorporated worst scenarios much less severe than the worst in the market realities, management might not have been able to make an unbiased judgment.

- The external risk factors have contagion effect on one another. The risk model of L Co might not have accounted for all the significant contagion risks' impact in unseen changes in external risk factors. Dedicated resources are required to establish model assumptions with various testing, for instance, back-testing.

  Reflection on the management's judgment
  If assumptions on contagion risks do not match with the market realities, the management might not have arrived at a fair judgment on the risk positioning.

Section IIIC Best practice, and methods (in about 300 words)

Pursual to Section IIIA and IIIB, discuss the principles for effective monitoring risk factors and recommend the best practices and methods to ensure identification of early warning signals. (Include but not limited to credit administration compliance, tracking risk indicators, review of the forecast, report to senior management on risk profile analysis, and others).

The list below lists the best practices and methods for identifying early warning signals:

Best Practices for Effective Monitoring of Risk Factors to Identify Early Risk Signals

Resources, Framework, structure, process, documentation, and culture are prerequisites to efficient and effective risk monitoring for identifying early warning signals. The list below attempts to share the best practices which should be in place for the practical identification of early risk signals:

- Resources
  A bank must stack adequate resources for the credit risk management structure: trained and skilled people and finance.

- Framework

  Apply the "three lines of defense" risk model. The 1st, 2nd, and 3rd lines of defense are risk owners, risk controllers, and internal audit divisions.

- Structure

  The risk committee provides oversight of risk management. However, the support comes from the management committee, which includes the credit committee, the departments, and the frontlines.

- Process

  A bank should have a process to identify, measure, and monitor early warning signals. The signals identified cascade to the appropriate parties within the above structure.

- Documentation

  Documents form an essential part of knowledge management. Moreover, adequately prepared documentation (e.g., collaterals' legal title, repayment history, and others) enables efficient follow-up with clients during turnover and handover.

- Culture

  The Bank invested over the years to form a robust credit risk culture so that everyone across the organization contributes to the identification of early warning signals.

Methods to Identify Early Warning Signals

Given that the Bank is a medium size leading, its portfolio can be relatively simple, and its relationship managers understand the clients well. Moreover, since it has credit exposure in Hong Kong, China, the UK, and the USA, it should have allocated adequate resources to monitor these markets' macroeconomics. The list below suggests the methods to identify early warning signals of internal and external risk factors:

Risk factors	Monitoring process	Risk indicator examples
External risk (macro-economy) changes	- Macro-environment scanning on the economies - Geo-political situations review - Stress testing to identify any vulnerable portfolio under extreme situations - Collateral and guarantee review to see if any valuation deterioration	- Changes in government spending - Changes in private spending - Inflation rate (e.g., YOY < 4%) - Govt debt/GDP (e.g., <50%)
External risk (Industry) changes	- Business environment scanning on the industry sectors - Portfolio analysis to determine if any characteristics change	- Real estate market correction (<5% over 3 months) - Commodity price (e.g., crude oil >$100)
Internal (Entity) risk changes	- Connect with peers in banking industry to obtain more perspective about clients - Credit administration on the individual accounts - Establish alert triggers at several levels of the reporting system - Monitor the migration of internal rating - Borrower's information change	- Sales - Gross Profit - Net Profit - Debt/Equity

..

Section IV Constraints of the recommendations and potential solutions (in about 300 words)

Demonstrate professionalism by applying impartial and unbiased judgment with the discussion of the constraints of the recommendation in Section (IIIC) and suggest potential solutions to overcome. Also, include the required disciplines to ensure unbiased judgment and timely response to early warning signals.

There are four sources of constraints to the recommended methods in Section IIIC. The table below attempts to list the constraints and potential solutions to overcome.

Category	Constraints to the recommendation	Potential solutions and disciplines to overcome the constraints
Data & Information	Structure	• Establish comprehensive knowledge management structure for easy data retrieval
	Compliance	• Ensure compliance of credit administration process so that inhouse data on clients (e.g., payment timeliness) are generated
	Timeliness	• Automation of data input and output speeds up the information generation
	Information asymmetry	• Establish trustful relationship with clients • Monitor news, rumours, press release, and other available information about clients' business • Establish industry network and banking network to gather intelligence about the clients' business
Model	Parameters - Selection	• Continual knowledge management to cumulate inhouse intelligence, industry information and research insight, so that the risk model parameters fully align with credit risk strategies
	Parameters - Contagious effect	• Resources allocation for risk modelling validation with inhouse stakeholders and outcomes of third-party models
	Assumptions - Scenario	• Frequent communications across the organizations to reassure that it's for the best of the Bank's interest to stretch the worst scenarios for stress-testing
	Assumptions - Forecast	• Thorough environment scanning and industry networking to collect sufficient information for forecast assumptions
Judgment	Product features	• Continual professional education to the senior management in a more private and lively way with, for instance, video briefing
	Exercise unbiased judgement	• Continual professional education with regular experience sharing on live cases
	Assessment of the borrowers' resilience in face of adverse situation	• Establish a trustful relationship with the clients to help clients to always maintain a healthy business • Frequent visits to the client's place of businesses for physical observation. • Frequent interactions with the client's customers in case of virtual business environment

	Treating early warning signal as noises	• Regular risk review meeting to discuss the outcomes from the analysis of the risk measures
	Credit risk management culture	• Establish an accountability culture with consequence management • Reinforce the culture with balanced compensation rewarded to revenue generators and board of directions e.g., reward successful transactions rather than reward for immediate revenue
Resources	Finance	• Maintain a strong finance function to ensure adequate appropriation of resources for meet short term and long-term need in credit risk management
	Human Resources	• Maintain a sustainable human resources talent pipeline within the Bank to encourage in-house talent transfers, e.g., transfer of experienced relationship managers to credit departments, and to attract external talents
	Information & technology	• Constant upgrade of information system
	Third party database	• Make use of third-party service providers for models and analysis built upon real time big data for validation of outcomes from inhouse models

Section V Reference links

Lists all references deployed to complete the case report.

- Hong Kong Banking Report 2022 (assets.kpmg)
- China's economy loses momentum as COVID curbs hit factories, consumers | Reuters
- Hong Kong's steep slide shows misplaced priorities | Reuters
- UK economy to shrink in 2023, risks 'lost decade': CBI | Reuters
- IMF again cuts U.S. 2022 growth forecast to 2.3% as consumer spending cools | Reuters
- Why Do We Miss Early Warning Signals Of Emerging Crises? (forbes.com)
- China House Prices Growth | Economic Indicators | CEIC (ceicdata.com)
- Too Big to Fail: Definition, History, Examples, and Reforms (investopedia.com)
- Barings collapse 25 years on: What the industry learned after one man broke a bank (cnbc.com)
- The Barings Collapse: A Regulatory Failure, or a Failure of Supervision (brooklaw.edu)

Section VI Presentation Slides

Attach the presentation slides to highlight the key items of the executive report. Use the same slides for a 10 – 15 minutes presentation, if requested by the trainer, before the trainer's feedback.

The Learner refers to the executive reports and prepares extracts for the PowerPoint Slides.

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Appendix 5 – Sample – Refresher on Modules 1 and 2

Note to trainers

(1) Please refer to Section (E) Subsection 7.3 (I) regarding target learners of pre-class refreshers on Modules 1 and 2 (2) Trainers should determine the format of refresher on Modules 1 and 2, as well as the passing mark. Reference can be made to the content outline in Part E Learning and Teaching Guide. The sample below is developed according to the content outline of Module 1 Submodule 1 on early warning signal.

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
1-What is the significance of credit risk management in the context of the CAMEL rating.	**1-What is the significance of credit risk management in the context of the CAMEL rating?**
Suggested answer: Credit risk management plays a crucial role in the CAMEL rating, which evaluates a bank's health across five dimensions: (1) Capital adequacy, (2) Asset quality, (3) Management, (4) Earnings, and (5) Liquidity. Effective credit risk management, as part of the asset quality component, directly influences a bank's ability to manage and mitigate potential losses from credit defaults. This in turn affects the bank's overall stability and soundness, as reflected in the CAMEL rating.	*Suggested choices:* A-It solely determines the bank's capital adequacy. **B-It is crucial for the asset quality component, influencing the bank's ability to manage potential losses from credit default.** C-It only affects the management aspect of the bank. D-It has no impact on the CAMEL rating. *Suggested answer: B*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
2-How does corporate finance theories relate to credit risk management	**2-How does corporate finance theories relate to credit risk management**
Suggested answer: Corporate finance theories relevant to credit risk management methods provide a foundational framework for understanding and managing this risk. These theories help in developing strategies that align with the bank's risk appetite and regulatory requirements, thereby maintaining a balance between risk and return, crucial for the bank's long-term sustainability and profitability.	*Suggested choices:* **A-They provide a framework for managing risk in alignment with regulatory requirements.** B-They focus exclusively on maximizing short-term profits C-They are only applicable to non-financial institutions D-They deal solely with the distribution of dividends. *Suggested answer: A*

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
3-What is a fundamental element of a credit strategy in portfolio credit risk management?	**3-What is a fundamental element of a credit strategy in portfolio credit risk management?**
Suggested answer: A fundamental element of a credit strategy in portfolio credit risk management is the effective management and monitoring of key risk areas within the credit portfolio. This involves identifying, assessing, and mitigating risks to ensure the portfolio aligns with the bank's overall risk appetite and strategic objectives.	*Suggested choices:* A-Prioritizing short-term gains over long-term stability B-Focusing exclusively on high-risk clients **C-Identifying crucial areas for continuous monitoring** D-Ignoring market trends and economic indicators *Suggested answer: C*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
4-Which of the following is an essential objective in portfolio credit risk management?	**4-Which of the following is an essential objective in portfolio credit risk management?**
Suggested answer: The primary objective in portfolio credit risk management is to optimize the risk-return profile of the credit portfolio, while maintaining compliance with regulatory standards and aligning with the bank's strategic objectives.	*Suggested choices:* A-Maximizing short-term profits B-Reducing all types of risks to zero **C-Managing and monitoring key risk areas** D-Focusing solely on low-risk clients *Suggested answer: C*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
5-What are the key levels at which signals for escalation are identified in credit risk management?	**5-What are the key levels at which signals for escalation are identified in credit risk management?**
Suggested answer: In credit risk management, signals for escalation are identified at three levels: the account level (individual borrower's credit risk signals), the portfolio level (aggregate credit risk within the entire portfolio), and the macro-economic level (wider economic factors impacting credit risk). Additionally, other essential signals may include industry-specific trends and regulatory changes.	*Suggested choices:* A-Account level only B-Portfolio level only C-Macro-economic level only **D-All of the above (account, portfolio, and macro-economic level)** *Suggested answer: D*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
6-What are the primary sources of changes that necessitate remedial actions in credit risk management?	**6-What are the primary sources of changes that necessitate remedial actions in credit risk management?**
Suggested answer: The main sources of changes prompting remedial actions in credit risk management include internal factors within the client organization, external factors such as industry trends, and broader market and economic conditions. Effective knowledge management of all inhouse, industry information and all external situations is crucial for identifying and addressing these changes.	*Suggested choices:* A-Internal organizational changes B-Industry-wide trends C-Market conditions **D-All of the above** *Suggested answer: D*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
7-What steps are crucial in exercising unbiased judgment in credit risk management?	**7-What steps are crucial in exercising unbiased judgment in credit risk management?**
Suggested answer: Exercising unbiased judgment in credit risk management involves reviewing and prioritizing the risk levels of industrial, other external factors, and internal factors. It also includes assessing the contagious effects on portfolio performance and assigning an independent party for ongoing risk monitoring.	*Suggested choices:* A-Review and prioritize risk level of industrial, other external factors, and internal factors B-Review and prioritize contagious effects on portfolio performance C-Assign an independent party for risk monitoring **D-All of the above** *Suggested answer: D*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
8-What are the key aspects of Credit Administration Function?	**8-What are the key aspects of Credit Administration Function?**
Suggested answer: The credit administration function primarily focuses on compliance with terms and conditions T&C and conducting operational reviews to ensure adherence to credit policies and procedures.	*Suggested choices:* A-Compliance with terms and conditions B-Operational review C-Financial analysis **D-A&B** *Suggested answer: D*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
9-How do key drivers of credit risk influence the detection of changes in risk indicators?	**9-Which of the following are key drivers of credit risk used to detect changes in risk indicators?**
Suggested answer: Key drivers, such as Exposure a Default (EAD), Probability of Default (PD), Loss Given Default (LGD), and Tenor, are crucial for detecting changes in risk indicators. They help in assessing risk both at a single debt level and across a portfolio, enabling banks to effectively evaluate and mange the overall credit risk.	*Suggested choices:* A-Exposure at Default (EAD) B-Probability of Default (PD) C-Loss Given Default (LGD) D-**All of the above** *Suggested answer: D*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
10-What are the key sources of guidelines for loan provisioning forecasts that banks should regularly refer to?	**10-What are the key sources of guidelines for loan provisioning forecasts that banks should regularly refer to?**
Suggested answer: Banks should regularly refer to the Hong Kong Monetary Authority (HKMA) guidance, which includes directives on loan provisioning, expected credit loss models, and multiple risk rating systems, Banks are also expected to engage in continual assessment of loan provisioning to ensure compliance and accuracy in their forecasting.	*Suggested choices:* A-HKMA guidance B-Expected credit loss models C-Multiple risk rating systems D-**All of the above** *Suggested answer: D*

…

Refresher on Module 1 Submodule 1 Early Warning Signals	
Version – Short Question	Version – MC Question
11-What roles do management play in credit risk monitoring, and what tools are available for their monitoring?	**111-What roles do management play in credit risk monitoring, and what tools are available for their monitoring?**
Suggested answer: Senior management plays a crucial role in credit risk monitoring by overseeing the overall risk profile and ensuring compliance with regulatory and economic capital requirements. Tools for their monitoring include standardized and IRB (internal rating based) approaches for risk analysis, credit loss absorption strategies, and regular risk profile reporting to informed decision-making	*Suggested choices:* A-Standardized risk analysis approach B-Internal Ratings-Based (IRB) approach C-Regulatory capital assessment D-**Both A&B** *Suggested answer: D*

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Appendix 6 – Sample – Refresher on Module 3

INTERACTIVE ETHICS AND COMPLIANCE QUIZ – QUICK, ENGAGING QUIZ TO REFRESH KNOWLEDGE ON CODES OF ETHICS, INTERNAL POLICIES, AND SALES COMPLIANCE GUIDELIENS.

Sample Given on Code of Conduct: 34-question version

1.1 Internal Control

1. What is the main purpose of AIs maintaining an internal control system?
a) To keep track of financial transactions.
b) To ensure staff members follow a dress code.
c) To ensure compliance with the Code of Conduct.
d) To monitor customer interactions.
Answer: c) To ensure compliance with the Code of Conduct.

2. Whose responsibility is it to manage misconduct cases in a timely manner?
a) The CEO of the AI.
b) The HR manager.
c) The Code of Conduct officer.
d) The AI staff members.
Answer: c) The Code of Conduct officer.

3. If a staff member doesn't comply with the Code of Conduct, what should the AI do?
a) Ignore the situation.
b) Terminate the staff immediately.
c) Promptly review the situation.
d) Inform external agencies.
Answer: c) Promptly review the situation.

4. What should AIs have in place to address conflicts of interest?
a) A set of written policies.
b) A weekly meeting.
c) An external audit.
d) A customer feedback system.
Answer: a) A set of written policies.

1.2 Communication to Staff

5. What is crucial for enforcing a Code of Conduct?
a) An annual seminar.
b) Understanding and active participation by staff.
c) Hiring external consultants.
d) Having a long Code of Conduct.
Answer: b) Understanding and active participation by staff.

6. How should changes to the Code of Conduct be communicated to staff?
a) Through external media.
b) Through internal circulars and training programs.
c) Only through email.
d) Once in an annual report.
Answer: b) Through internal circulars and training programs.

1.3 Regular Review

7. How frequently should the Code of Conduct be reviewed by the Board?
a) Quarterly.
b) Monthly.
c) Biannually.
d) At least annually.
Answer: d) At least annually.

8. Who is responsible for compliance monitoring for a Hong Kong branch of an overseas-incorporated AI?
a) The CEO.
b) Senior management.
c) The Board.
d) The local government.
Answer: b) Senior management.

1.4 Segregation of Conflicting Responsibilities

9. What should AIs establish to prevent accidental communication of confidential info between departments?
a) VPNs.
b) Digital firewalls.
c) Chinese Walls.
d) Digital signatures.
Answer: c) Chinese Walls.

10. Who should have access to confidential information?
a) All staff members.
b) Only senior management.
c) Staff with a specific business purpose.
d) External consultants.
Answer: c) Staff with a specific business purpose.

1.5 Record Maintenance

11. Which records should AIs maintain?
a) Only financial transactions.
b) Personal benefits retained by staff and conflict of interest declarations.
c) Daily activities of each staff member.
d) External communications.

Answer: b) Personal benefits retained by staff and conflict of interest declarations.

1.6 Reporting Channels

12. To whom should staff report matters that could give rise to fraud or deception?
a) Their immediate supervisor.
b) The CEO.
c) The local police.
d) The Code of Conduct officer.
Answer: d) The Code of Conduct officer.

13. What should be the nature of reporting channels?
a) Public and open.
b) Confidential and without risk of reprisal.
c) Only through written letters.
d) Available only during business hours.
Answer: b) Confidential and without risk of reprisal.

1.7 Audit

14. What is the main purpose of audits as per the Code of Conduct?
a) Assess financial performance.
b) Assess the effectiveness of the systems required.
c) Evaluate staff performance.
d) Review customer satisfaction.
Answer: b) Assess the effectiveness of the systems required.

15. To whom should audit findings be reported?
a) Only to senior management.
b) To all staff members.
c) To the Board or a Board-level committee.
d) To external agencies.
Answer: c) To the Board or a Board-level committee.

1.8 Assistance from Law Enforcement and Regulatory Authorities

16. Who can assist AIs in developing ethics programs?
a) The local library.
b) Any external consultant.
c) The ICAC's regional offices or the Hong Kong Business Ethics Development Centre.
d) The local council.
Answer: c) The ICAC's regional offices or the Hong Kong Business Ethics Development Centre.

17. For what might AIs approach the ICAC?
a) Organizing annual parties.
b) Formulating a Code of Conduct and offering advice on implementation.
c) Providing technical IT solutions.
d) Designing office interiors.
Answer: b) Formulating a Code of Conduct and offering advice on implementation.

1.9 Conflicts of Interest

18. What should AIs do when staff misuse their position for personal gains?
a) Award them.
b) Reassign them to a different role.
c) Conduct an internal seminar.
d) Investigate and take appropriate action.
Answer: d) Investigate and take appropriate action.

19. Which of the following is a key concern for AIs when staff receives benefits?
a) The staff's personal preferences.
b) Receiving benefits from people they have business connections with.
c) The number of benefits received monthly.
d) The mode of delivery of the benefits.
Answer: b) Receiving benefits from people they have business connections with.

1.10 Staff Misconduct

20. When breaches of law occur in AIs, they often arise from:
a) System failures.
b) Economic downturns.
c) Staff misconduct.
d) Customer complaints.
Answer: c) Staff misconduct.

21. When a breach of the Code of Conduct occurs, what is a key expectation from the HKMA?
a) AIs should ignore it.
b) AIs should wait for HKMA's directives.
c) AIs should hold their staff accountable.
d) AIs should amend the Code.
Answer: c) AIs should hold their staff accountable.

1.11 Vigilance and Reporting

22. What should be an AI's immediate reaction to irregularities or misconduct?
a) Await further instructions.
b) Report it to the media.
c) Seek external consultation.
d) Senior management should take corrective measures.
Answer: d) Senior management should take corrective measures.

23. Regarding gifts and benefits, deviations from the policy should be reported to:
a) The entire staff.
b) The recipient's supervisor.
c) Senior management.
d) The HKMA directly.
Answer: c) Senior management.

1.12 Managing Conflicts of Interest

24. To maintain confidentiality, what should senior management ensure about staff on either side of the Chinese Walls?
a) They take turns in managing information.
b) They receive similar pay scales.
c) They don’t communicate about the information.
d) They work different shifts.
Answer: c) They don’t communicate about the information.

25. What measures should be in place to avoid unauthorized communication across Chinese Walls?
a) Frequent staff rotations.
b) Regular staff meetings.
c) Vigilant surveillance.
d) Appropriate preventive measures.
Answer: d) Appropriate preventive measures.

1.13 HKMA's Expectations

26. If the HKMA requests, what should AIs be prepared to provide?
a) A list of all their clients.
b) A list of all their business partners.
c) A written record of personal benefits retained by staff.
d) Monthly profit and loss statements.
Answer: c) A written record of personal benefits retained by staff.

27. Which of the following best encapsulates the HKMA's view on enforcing the Code of Conduct?
a) It's primarily the responsibility of AIs to ensure compliance.
b) It's mainly the HKMA's job to monitor AI's activities.
c) AIs should focus on profit, HKMA will handle compliance.
d) AIs should only intervene in major breaches.
Answer: a) It's primarily the responsibility of AIs to ensure compliance.

1.14 Seeking External Advice

28. Which body offers a Corruption Prevention Advisory Service?
a) The HKMA.
b) The local council.
c) The ICAC.
d) The AI's internal audit team.
Answer: c) The ICAC.

29. To ensure an effective Code of Conduct, AIs should ideally:
a) Rely solely on internal feedback.
b) Only consider the HKMA's guidelines.
c) Seek advice from external advisory bodies like the ICAC.

d) Change their code annually.
Answer: c) Seek advice from external advisory bodies like the ICAC.

1.15 Staff Training

30. Which of the following is NOT suggested by the HKMA for AIs to ensure staff are aware of the Code of Conduct?
a) Offering refresher courses regularly.
b) Communicating through internal circulars.
c) Ignoring the need for an induction course.
d) Bringing the Code to the attention of all staff.
Answer: c) Ignoring the need for an induction course.

31. What should be included in the induction course for new recruits?
a) A tour of the AI's facilities.
b) A summary of the AI's financials.
c) An overview of the Code of Conduct.
d) Training on the AI's software systems.
Answer: c) An overview of the Code of Conduct.

General Questions

32. Which term refers to functional segregation reinforced by physical separation?
a) Digital Walls.
b) Brick Walls.
c) Firewall.
d) Chinese Walls.
Answer: d) Chinese Walls.

33. What is the primary focus of the Code of Conduct?
a) Marketing strategies.
b) Product development.
c) Ethical behavioural and professional standards.
d) Profit maximization.
Answer: c) Ethical behavioural and professional standards.

34. How should potential misconduct cases reported by staff be managed?
a) Ignored until they escalate.
b) Addressed in a timely manner.
c) Documented but not acted upon.
d) Only discussed during annual
Answer b) Addressed in a timely manner.

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Appendix 7 – Sample - Simulation Case (2) – for Assessment

Case Sample

Aircraft Financing Negotiation

In 2020, Aviation Group Ltd., an aviation conglomerate registered in the city, initiated corporate reorganization strategy. This strategy included ceasing operations of a smaller airline subsidiary and ending the activities of a regional affiliate. The restructure required local cabin and cockpit staff to either adjust to new employment terms and conditions or accept a financial settlement for immediate departure. These changes enable the aviation group to survive the pandemic by reducing its monthly cash outflow substantially by USD60 million.

The rest, indeed, is history. Triggered by the 2020 pandemic, the aviation industry faced a critical downturn, leading to the collapse of many operators[116]. This turbulent period spurred a wave of mergers and acquisitions, often leaving the acquiring firms laden with new debts. As the pandemic waned, the industry eagerly awaited a rebound[117]. This phase was neatly summarized by a financial newspaper headline: “Airlines turn market darlings as COVID forces business rejig.” [118]

As the aviation sector is still wrestling with the uncertain persistence of the post-pandemic recovery magnitude, Aviation Group Ltd. is undergoing a significant strategic transformation. With a positive view on the short-haul sector, the company has embarked on a fleet renewal program, proposing to acquire 30 narrow-body jets to replace a similar number of wide-body aircrafts. This development has attracted the eyeballs of many banks in the city, including yours, which is reviewing the situation with careful optimism. Since the 4th quarter of 2022, senior team members of your bank have been vigilantly tracking the client’s activities to recognize the emerging business potentials in the aviation industry.

Situation

Four weeks ago, your supervisor requested you to help the senior members to prepare for a vital negotiation session with Aviation Group Ltd. You completed a detailed pre-negotiation template with the information provided by the senior RPs in the bank. (Your supervisor promised to bring you to the negotiation session as an observer if the outputs of your preparation added significant value to the negotiation tactics.)

Your preparation did contribute values. You were granted the opportunity to attend the negotiation which ended successfully with an initial mutual agreement of the deal.

To deepen your understanding of the negotiation flow, your supervisor arranged you to engage in a 10-minute mini role-play of the negotiation. The supervisor advised that, with more practice sessions, you will internalize the learnings on negotiation.

[116] The Eight Airlines Most at Risk of Failure as Covid-19 Drags On - Bloomberg
[117] Airlines Are Watching One Number: the Return-to-Normal Metric - Bloomberg
[118] Airlines Turn Market Darlings as Covid Forces Business Rejig - Bloomberg

Assessment Questions and Deliverables

<u>Short Questions (Maximum 20 points)</u>

Required
Generate insight from analyzing the negotiation circumstance for developing negotiation tactics.

Deliverables
Complete Interim Summary I, II, and III in the preparation templates provided in Case Appendix 6, then copy and paste your responses the response template provided in Case Appendix 7. The trainer will ask you to submit the templates during the class.

Question 1 (Maximum 7 points)
-Capture the insight related to negotiation tactics

Question 2 (Maximum 7 points)
-Recommend the structure of bank's offer, analyse the negotiation paradigm and evaluate strength

Question 3 (Maximum 7 points)
-Anticipate concerns, counteroffer, exit strategy, and formulate overall negotiation tactics

<u>Long Questions (Maximum 40 points)</u>

Required
Analyze the negotiation situations are necessary for insight generation, then development of negotiation tactics.

Deliverables
Complete Part (I) and (II) of the templates provided in Case Appendix 6. The trainer will ask you to submit the templates during the class.

Question 1 (Maximum 8 points)
-Align balanced offer to negotiation key drivers (Template Part I)

Question 2 (Maximum 32 points)
-Adapt the balanced offer to situations (Template Part IIA, IIB, IIC, IID, IIE)

<u>Note to learners: Please organize response of questions in analytical framework e.g., table format, hierarchy etc., to quote facts, compare and contrast different approaches or theories, and to evaluate real-life applications supported by examples.</u>

<u>Case-Based Questions (Maximum 40 points)</u>

Required
Demonstrate to integrate relevant knowledge, skills, and behaviors in negotiation dialogues.

Deliverable
You will receive further information during class about the dialogue assessment to be conducted by the trainer/assessor.

Case Appendix 1

Explanation of the Case

Case Objective

This simulation case assessment activity fosters moments of self-discovery and deepens the learners' understanding in areas requiring thorough negotiation knowledge, skills, and behaviours.

Case

The information given in this document provides the basis of the real situation, such as the business or the product, the internal and external market environment. However, they are meant to serve as food for thought, rather than serving as a complete set of contextual information, for the learners to start preparing the responses. The learners are to conduct supplementary research to balance and to complete their analysis in the templates.

Case Appendix 2

Food for Thought

Note to the trainers

This section provides food for thought to warm a learner before preparing a pre-negotiation analysis and the negotiation flow. It also provides directions for the learner to research further relevant information about the industry and comparable clients, generating insights for the analysis to develop a negotiation tactic.

Note to learners: During class, you will share the insight generated and the grounds of the analysis to broaden and deepen the learning.

(1)Pre-negotiation preparation

Aviation Group Ltd, the Client, is an existing client. It would help if you gauged the client's situations, needs, and likely negotiation stance to develop your negotiation strategy. The focus is on understanding the impact of the present macroeconomic environment, the client's strategic shift towards short-haul markets, fleet modernization, and financial constraints. While you may also refer to more public information for additional insight generation, the case provides you with essential information and requirements on deliverables for assessment:

· Case appendix 3A – About the bank
· Case appendix 3B – About the client
· Case appendix 4 – About the market dynamics
· Case appendix 5 – Relevant reference

> **Food for thought**
> Negotiation is dynamic, and a slight change can influence critical drivers. Do supplementary research to identify any surging trends that will weaken or strengthen the relative position powers of the bank or the client. The research outcomes will bring your pre-negotiation preparation up-to-date and relevant to the negotiation flow.

(2)Negotiation flow

Your supervisor will arrange for you to go through a 10-minute role-play. You need to be convinced that your negotiation tactics are grounded in solid case analysis and ready to embed them in effective dialogues.

> **Food for thought**
> Get familiarized with the essential stages of negotiation and be ready to guide the clients through them to attain a mutual understanding of the negotiation positions so that an aligned and balanced offer is accepted. Reflect on the live cases you have handled and recall the critical success elements in each negotiation stage.

Case Appendix 3A

About Your Bank

Note to trainers

(1) Purpose: This section aims to prompt learners' critical thinking and guide their research direction. The section design helps the learners understand Aviation Group Ltd.'s possible negotiation approach, vital for completing the pre-negotiation template. (2) Research: Do urge the learners to explore their own internal banking scenarios and public domain information on aviation industry trends and cycles. Comparing Aviation Group with similar-scale airline companies locally or overseas can offer additional insights. (3) Economic context: including current economic indicators such as interest rate trends, inflation rates, and GDP growth will give the learners a more realistic backdrop. (4) Scenario building: the learners may determine the best plausible scenario for their analysis, supported by reasonable justification.

Background - Bank profile and strategy

Leadership and team

The Bank features a diverse global leadership and a specialized aviation team experienced in complex industry transactions.

Network and analysis capability

It maintains a robust aviation network and senior managers continuously analyze industry trends and critical accounts to manage credit risk effectively.

Credit strategy and relationship with Aviation Group Ltd

The Bank, despite recent strains, has maintained a 60-year relationship with Aviation Group Ltd. when it started the business with only one plane. Its aviation-specific credit policies (pre-pandemic) aligned with strategic lending and risk assessment goals.

Case Appendix 3B

About the Client

Note to trainers

(1) Encourage learners to analyze the client's relationship dynamics, financial health, and the client's strategic direction, drawing from their leadership profiles, public perception, and simulated financial data. (2) Prompt consideration of Aviation Group Ltd.'s historical and current financial choices, including its bond market activity and preferences for bank terms. (3) Guide learners to assess how Aviation Group Ltd.'s strategies and credit rating might influence their negotiation approach.

Leadership

- The parent company of Aviation Group Ltd. is a long-established conglomerate led by a team with diverse business venture experience.
- The bank's senior account manager in aviation maintains a strong professional bond with Aviation Group Ltd.'s CFO, a prominent figure in the aviation sector with extensive knowledge of the cargo and passenger industry.
- The CEO, a seasoned professional with deep roots in customer relations and commercial management of low-cost aircraft operations, directly supervises the CFO.
- The CEO was on board for two years and has ambitious plans to lead the company into a new era. He is more than keen to get Aviation Group Ltd.'s performance in all aspects.

Business strategy

- Aviation Group Ltd is shifting focus to short-haul flights, seen as less affected by geopolitical changes, and is diversifying routes to include the expanding south-east market.

Financial health

- The client's restructuring efforts have been pivotal in maintaining minimal financial health during the pandemic.
- While recovery post-pandemic has been slower than management anticipated, The Client's performance aligns with market standards.
- The Client has historically explored bond markets in the 90s and prefers banking terms for financing and it is public information known to the banking industries.
- The listed price per newly ordered aircraft is USD 4.66 billion, and the Client gets a significant discount through exercising a purchase option.

Parent company's credit rating

- The parent company of Aviation Group Ltd. has a credit rating of A -- from an independent credit rating agent, and its outlook being stable.

Reputation and public perception

- The Aviation Group Ltd. enjoys a generally positive public image despite occasional customer service issues catching the eyes and ears of the public.

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Aviation Group Limited
Consolidated Statement of Profit or Loss and Other Comprehensive Income

	2022 $M	2021 $M	2020 $M	2019 $M	2018 $M
Revenue					
Passenger services	748	11,950	73,985	73,119	66,408
Cargo services	12,702	27,890	23,810	28,316	23,903
Catering, recoveries and other services	2,404	7,094	9,178	9,625	6,973
Total revenue	15,854	46,934	106,973	111,060	97,284
Expenses					
Staff	(5,746)	(15,786)	(20,125)	(20,211)	(19,962)
Inflight service and passenger expenses	(141)	(1,102)	(5,306)	(5,292)	(4,996)
Landing, parking and route expenses	(2,293)	(6,868)	(17,758)	(17,486)	(15,225)
Fuel (including hedging losses)	(2,312)	(11,379)	(29,812)	(33,869)	(31,112)
Aircraft maintenance	(1,798)	(5,772)	(9,858)	(9,401)	(9,607)
Aircraft depreciation and operating leases	(5,234)	(11,879)	(12,022)	(12,743)	(11,845)
Other depreciation, amortisation and operating leases	(1,198)	(2,720)	(2,991)	(2,851)	(2,795)
Commissions	(16)	(146)	(927)	(862)	(681)
Others	(1,648)	(2,987)	(4,847)	(4,750)	(3,340)
Total operating expenses	(20,386)	(58,639)	(103,646)	(107,465)	(99,563)
Operating loss before non-recurring items	(4,532)	(11,705)	3,327	3,595	(2,279)
Gain on disposal of a long-term investment	-	-	-	-	586
Gain on deemed partial disposal of an associate	-	-	114	-	244
Restructuring costs	(403)	(2,383)	-	-	-
Impairment and related charges	(500)	(4,056)	-	-	-
Profit/(Loss) from operations	(5,435)	(18,144)	3,441	3,595	(1,449)
Finance charges	(1,307)	(3,044)	(3,276)	(2,457)	(2,223)
Finance income	58	149	337	343	462
Net finance charges	(1,249)	(2,895)	(2,939)	(2,114)	(1,761)

Share of associates' profits/(losses)	(1,509)	(1,282)	1,643	1,762	2,630
Profit/(Loss) before taxation	(8,193)	(22,321)	2,145	3,243	(580)
Income tax	629	674	(454)	(466)	(308)
Profit/(Loss) after taxation	(7,564)	(21,647)	1,691	2,777	(888)
Other comprehensive income					
Items that may not be reclassified to profit or loss:					
Defined benefit plans	-	599	1,061	(270)	702
Revaluation of equity investments at fair value, non-recycling	-	-	33	-	-
Items that may be reclassified subsequently to profit or loss:					
Cash flow hedges	3,251	(1,041)	551	1,586	4,352
Revaluation of available-for-sale financial assets	-	-	-	-	(403)
Share of other comprehensive income of associates	162	(203)	(186)	628	470
Exchange differences on translation of foreign operations	251	1,638	(472)	(1,495)	1,874
Total comprehensive income for the year	(3,900)	(20,654)	2,678	3,226	6,107
Profit/(Loss) attributable to:					
Ordinary shareholders	(7,858)	(21,876)	1,691	2,345	(1,259)
Preference shareholders	293	228	-	-	-
Non-controlling interests	1	1	-	432	371
	(7,564)	(21,647)	1,691	2,777	(888)
Total comprehensive income/(loss) attributable to:					
Ordinary shareholders	(4,194)	(20,883)	2,678	2,794	5,736
Preference shareholders	293	228	-	-	-
Non-controlling interests	1	1	-	432	371
	(3,900)	(20,654)	2,678	3,226	6,107

Consolidated Statement of Financial Position	2022	2021	2020	2019	2018
	$M	$M	$M	$M	$M
Non-current assets					
Property, plant and equipment	128,252	131,925	140,114	117,124	111,182
Intangible assets	15,062	15,061	15,151	11,174	11,221
Investments in associates	25,302	26,489	27,055	27,570	28,144
Other long-term receivables and investments	3,287	2,905	3,823	4,015	4,068
Deferred tax assets	753	627	1,089	793	928
	172,656	177,007	187,232	160,676	155,543
Current assets					
Inventory	1,596	1,719	1,812	1,828	1,515
Other receivables and other assets	5,132	3,088	5,049	5,916	5,230
Accounts receivables	2,679	3,381	5,559	6,559	6,131
Assets held for sale	48	38	-	-	865
Liquid funds	23,557	19,341	14,864	15,315	19,094
Total assets	205,668	204,574	214,516	190,294	188,378
Equity and liabilities					
Capital and reserves					
Share capital	48,322	48,322	17,106	17,106	17,106
Other reserves	21,560	24,935	45,667	46,830	43,995
	69,882	73,257	62,773	63,936	61,101
Non-controlling interests	5	4	3	3	171
Total equity	69,887	73,261	62,776	63,939	61,272
Non-current liabilities					
Long-term liabilities	73,894	68,880	76,508	60,183	69,506
Other long-term payables	4,386	4,210	4,806	4,649	3,502
Deferred tax liabilities	11,227	11,499	13,564	13,178	12,820
	89,507	84,589	94,878	78,010	85,828
Current liabilities					
Current portion of long-term liabilities	24,802	24,249	20,752	13,694	8,888
Trade and other payables	10,635	12,376	18,218	17,646	17,057
Contract liabilities	8,922	8,122	15,941	15,792	13,961
Taxation	1,915	1,977	1,951	1,193	1,372
Bank overdraft - unsecured	-	-	-	19	-
Dividend payable to non-controlling interests	-	-	-	1	-
Total equity and liabilities	205,668	204,574	214,516	190,294	188,378

Case Appendix 4
About the Market Dynamics

Note to trainers

Encourage learners to analyze how these market dynamics might influence Aviation Group Ltd's strategic decisions and negotiation stance. This background is critical in understanding the broader context in which Aviation Group Ltd. operates.

Travel dynamics with China

- Reduced air travel to and from China, a critical market, significantly affects airline revenues.

Aircraft supply bottlenecks

- Pandemic-related supply issues have led to delays in fleet expansion and modernization, impacting operational efficiency and competitiveness.

Russian airspace closure

- Geopolitical developments resulting in longer flight routes increase operational costs for affected airlines.

Middle East geopolitical tensions

- Ongoing geopolitical unrest odds layers of uncertainty to airline operations and scheduling.

Operational risk incidences

- Recent incidents like the pricing glitches leading to extremely low-cost tickets highlight the risk associated with internet bookings. Airlines are continuously addressing safety, technological, and environmental risks.

Interest rate environment

- Pre-2022 low rates: low-interest rates have been advantageous for capital-intensive industries like aviation.
- Rising rates in 2022: an upward trend in interest rates, driven by inflation, is increasing borrowing costs, affecting operational budgets and new investments.
- Historical context: despite recent increases, current interest rates are still moderate when viewed against a more prolonged historical backdrop.

Industry profits

- The industry's projected profits in 2023 are expected to be less than 40% of the 2019 levels, with a slow recovery in business travel.

Case Appendix 5
Relevant Reference Materials

Optional Reading
Sample industry intelligence: • Global airlines cheat sheet, Bloomberg intelligence – industrials, Global-Airlines-Bloomberg-Guide.pdf (uconn.edu) **Industry outlook – worldwide** • Boeing Closes In on 737 Target After November Delivery Spurt - Bloomberg • Aviation Leaders Report 2023 - New Horizons (kpmg.com) • Air Travel Finally Reaches Pre-Covid Levels, But Profits Suffer - Bloomberg **Industry outlook – Hong Kong** • Hong Kong Aviation Recovery Is Coming Much Sooner Than Expected - Bloomberg **Market competition** • Standard Chartered in talks to sell aviation finance unit to AviLease - Bloomberg News - June 05, 2023 at 11:39 am EDT | MarketScreener • Three-Hour Flights as Cheap as $1 in China After System Glitch - Bloomberg **Factors affecting industry performance - fuel price** • Oil Prices: Jet Fuel Demand Flies Again - Bloomberg **Factors affecting industry performance - sustainable environment** • Aviation: The Industry's Path to Becoming Green Doesn't Exist - Bloomberg **Factors affecting post-COVID business recovery momentum** • Cathay Pacific to Reduce Flights Through to End of February - Bloomberg **Collateral decision in Hong Kong** • Corporate Loan Pricing and Collateral Decision in Hong Kong (hkma.gov.hk) **Bank product information** • Module 3 Submodule 1 Bank Products and Credit Facility Structure

Case Appendix 6
Pre-negotiation preparation – steps to complete the template for scoring

Note to learners: (1)The table below captures the structure of the templates on "Pre-Negotiation Preparation on Tactics." (2) The template design aligns with the ILO of the pre-negotiation preparation process, meaning that learners will be familiar with the pre-negotiation preparation upon completion of the responses required in the templates. (3)Follow and complete all the steps as indicated in the templates. (4) The trainer/assessor will ask you to submit your responses in the templates in Case Appendix 6 and 7. (5)The templates require responses in specific formats, such as (i) filling in the blank, (ii) circling the answer, or (iii) writing the text. (6) Fill in the softcopy of the templates.

TEMPLATE STRUCTURE				
Part	**Section**	**Task**	**Questions**	**Topic**
I	Aligning balanced offer to negotiation's key drivers			
	A	Strategic alignment on key success drivers of negotiation		
		1	Capture insight on negotiation tactics	
			1	Long term interest – strategic purpose
			2	Short term interest – business need
			3	Bottom line – the least to accept
			4	Best alternative to a negotiated agreement
			5	Solutions – Bank's options of offers and client's potential counteroffers
			6	Solutions – Bank's concession causing deviations
	B	Strategic alignment on leverage components of negotiation		
		2	Recommend/structure the bank's balanced offer	
			7	Legitimacy
			8	Commitment
			9	Relationship
			10	Communication
II	Adapting balanced offer to situations			
	A	Negotiation paradigm		
		3	Analyze negotiation paradigm and potential clash	
			A1	Anticipated paradigm
			A2	Anticipated behavioural clashes
			A3	Anticipated ethical boundary
	B	4	Evaluate negotiation strength	
			B1	Information strength
			B2	Place strength
			B3	Power factor
	C	5	Anticipate concerns and evaluate their impact on the bank's balanced offer	
			C1	Maximum gain estimated
			C2	Anticipated concerns
			C3	Anticipated objections
	D	6	Anticipate the client's counteroffer and evaluate the bank's adaptation	
			D1	Compliance
			D2	Risk tolerance
			D3	Application risk
			D4	Portfolio risk exposure
			D5	Revenue
			D6	Cost
			D7	Trust/Others
			D8	Relationship/Others
	E	7	Develop and execute exit strategy	
			E1	Triggering event
			E2	Timing of exit
			E3	Likelihood to execute exit plan
III	Formulation of Negotiation Tactics			
		8	Formulate overall negotiation tactics based on insights generated from task 1 to 7 in previous sections	

<table>
<tr><th colspan="5">TEMPLATE – PRE-NEGOTATION PREPARATION ON TACTICS</th></tr>
<tr><th colspan="5">Part (I) ALIGNING BALANCED OFFER TO NEGOTIATION'S KEY DRIVERS</th></tr>
<tr><td rowspan="30">STEP 1 - DEVELOPING A BALANCED OFFER (Complete 1 - 10)</td><td colspan="4">(A) Strategic alignment on 6 key success drivers of negotiation
1-Lont term interest[119]: In interest-based negotiations, the intent is to reach a mutually agreed acceptable outcomes, sometimes that is mutually beneficial to both parties.
2-Short term interest: Revealing from financial analysis, financial strength and credit strength analysis regarding the immediate business needs mutually beneficial to both parties.
3-Bottom line: The lowest acceptable point or the final offer a party is willing to accept in a negotiation.
4-BATNA: Best alternative to a negotiated agreement, defined as the most advantageous alternative that a bank can take if negotiation fail, and an agreement cannot be made
5-Option: Available choices parties might consider satisfying their interests, including conditions, contingencies and trades.
6-Concession: Adjusting on certain demands or positions to facilitate reaching an agreement</td></tr>
<tr><td colspan="4">How to fill in the template?
Note 1: "Q" = Facilitating Question.
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the I-interim summary</td></tr>
<tr><th></th><th>Key Drivers</th><th>Bank's Perspective</th><th>Client's Perspective</th></tr>
<tr><td rowspan="5">1</td><td>Long term interest – strategic purpose</td><td>Q-Refer to the Bank's credit strategy, what are our goals for the future? How do this align with this negotiation?</td><td>Q-Refer to the client's business strategy, what are the client's long-term business objectives? How can we align with them?</td></tr>
<tr><td>• Must have</td><td>I1a-Fill in the blank below:</td><td>I1d-Fill in the blank below:</td></tr>
<tr><td>• Should have</td><td>I1b-Fill in the blank below:</td><td>I1e-Fill in the blank below:</td></tr>
<tr><td>• Nice to have</td><td>I1c-Fill in the blank below:</td><td>I1f-Fill in the blank below:</td></tr>
<tr><td colspan="3">I1g-Bank-client gap – insight from above analysis</td></tr>
<tr><td rowspan="5">2</td><td>Short term interest – business need</td><td>Q-Refer to the Bank's business strategy, what immediate business needs must this negotiation address?</td><td>Q-Refer to the outcomes of the financial analysis on the client, what are the client's current financial priorities?</td></tr>
<tr><td>• Must have</td><td>I2a-Fill in the blank below:</td><td>I2d-Fill in the blank below:</td></tr>
<tr><td>• Should have</td><td>I2b-Fill in the blank below:</td><td>I2e-Fill in the blank below:</td></tr>
<tr><td>• Nice to have</td><td>I2c-Fill in the blank below:</td><td>I2f-Fill in the blank below:</td></tr>
<tr><td colspan="3">I2g-Bank-client gap – insight from above analysis</td></tr>
<tr><td rowspan="4">3</td><td>Bottom line – the least to accept</td><td>Q-Refer to inhouse analytics from similar cases for worst case, base case and best case, what is our minimum acceptable outcome from this negotiation?</td><td>Q-Refer to inhouse analytics on the same client for worst case, base case and best case, what might be the client's minimum expectations?</td></tr>
<tr><td>• Financial</td><td>I3a-Fill in the blank below:</td><td>I3c-Fill in the blank below:</td></tr>
<tr><td>• Non-financial</td><td>I3b-Fill in the blank below:</td><td>I3d-Fill in the blank below:</td></tr>
<tr><td colspan="3">I3e-Bank-client gap – insight from above analysis</td></tr>
<tr><td rowspan="3">4</td><td>BATNA –
(Best Alternative to a Negotiated Agreement)</td><td>Q-Refer to inhouse analytics of similar cases for BATNA in worst, base, and best BATNA, what is our best alternative?</td><td>Q-Refer to inhouse analytics on the same client's cases for BATNA in worst, base, and best BATNA, what is client's best alternative?</td></tr>
<tr><td>Tangible</td><td>I4a-Fill in the blank below:</td><td>I4c-Fill in the blank below:</td></tr>
<tr><td>Intangible</td><td>I4b-Fill in the blank below:</td><td>I4d-Fill in the blank below:</td></tr>
</table>

[119] Interest-based negotiation, Neil Katz & Kevin McNulty, 1995, Interest-Based Negotiation (syr.edu)

5	Bank's options of offers and client's possible counteroffers (Minimum 5 options)	Q-What's our base offer? Refer to inhouse analytics on the same client's cases	Q-What's the counteroffer? Refer to inhouse analytics on the same client's cases
	• Option 1	***I5a-Fill in the blank below:***	***I5f-Fill in the blank below:***
	• Option 2	***I5b-Fill in the blank below:***	***I5g-Fill in the blank below:***
	• Option 3	***I5c-Fill in the blank below:***	***I5h-Fill in the blank below:***
	• Option 4	***I5d-Fill in the blank below:***	***I5i-Fill in the blank below:***
	• Option 5	***I5e-Fill in the blank below:***	***I5j-Fill in the blank below:***
6	Solutions – Bank's concessions causing (or not) deviations	Q-What's our potential concession?	Q-What's the client's expected concession?
	• Option 1	***I6a-Fill in the blank below:***	***I6d-Fill in the blank below:***
	• Option 2	***I6b-Fill in the blank below:***	***I6e-Fill in the blank below:***
	• Option 3	***I6c-Fill in the blank below:***	***I6f-Fill in the blank below:***
(B) STRATEGIC ALIGNMENT ON LEVERAGE COMPONENTS OF NEGOTIATION 7-Legitimacy: establish the fairness, process and outcomes and justifiability of the negotiation process and outcomes 8-Commitment: establish dedication to the negotiation process and adherence to any agreed terms 9-Relationship: establish the interpersonal and professional dynamics to maintain or enhance the relationship 10-Communication: establish effective exchange of information, proposals, and feedback throughout the negotiation			
How to fill in the template? *Note 1:"Q" = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)*			
7	**Key Drivers**	**Q-What is the view from Bank's Perspective?**	**Q-What is the view from Client's Perspective**
	Legitimacy		
	• Strong	***I7a-Fill in the blank below:***	***I7c-Fill in the blank below:***
	• Weak	***I7b-Fill in the blank below:***	***I7d-Fill in the blank below:***
8	Commitment		
	• Strong	***I8a-Fill in the blank below:***	***I8c-Fill in the blank below:***
	• Weak	***I8b-Fill in the blank below:***	***I8d-Fill in the blank below:***
9	Relationship		
	• Strong	***I9a-Fill in the blank below:***	***I9c-Fill in the blank below:***
	• Weak	***I9b-Fill in the blank below:***	***I9d-Fill in the blank below:***
10	Communication		
	• Strong	***I10a-Fill in the blank below:***	***I10c-Fill in the blank below:***
	• Weak	***I10b-Fill in the blank below:***	***I10d-Fill in the blank below:***
I-Interim summary on expected outcomes ***(Use template softcopy for extra space)*** *Task (1) Capture insight on negotiation tactics - from analysis of the 10 key success drivers* *Task (2) Recommend/structure the Bank's balanced offer.*			

Part (IIA) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 2 – EVALUATING NEGOTATION PARADIGM

A-NEGOTIATION PARADIGM

How to fill in the template?

Note 1: "Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the IIA-interim summary

IIA-Fill in the information.

Counterpart	Name	Dept	Title	Decision Authority
Bank				
Client				
…				

	Attributes	Q-Which party adopts the Distributive Paradigm i.e. win-loss	Q-Which party adopts the Integrative Paradigm i.e. win-win
A1	Anticipated Paradigm	Position-based[120] Distributive i.e. win-loss	Interest-based Integrative i.e. win-win
		IIA1a-Circle the party(s) likely to demonstrate the above paradigm: ***1-Bank 2-Client***	***IIA1b-Circle the party(s) likely to demonstrate the above paradigm:*** ***1-Bank 2-Client***
A2	Anticipated behavioural clashes	Factors leading to higher propensity for position-based/distributive paradigm: Personality: competitive Gender: assertive Culture: distinctive norm	Factors leading to higher propensity for interest-based/integrative paradigm: Personality: withdrawing Gender: collaborative Culture: diversified
		IIA2a-Circle the party(s) likely to demonstrate above behaviours: ***1-Bank 2-Client***	***IIA2b-Circle the party(s) likely to demonstrate the above behaviours:*** ***1-Bank 2-Client***
A3	Anticipated ethical boundary	Unethical negotiation -Manipulative -Coercive -Do not anticipate	Unethical negotiation -Excessive concession -Do not anticipate
		IIA3a-Circle the party(s) likely to demonstrate above behaviours: ***1-Bank 2-Client***	***IIA3b-Circle the party(s) likely to demonstrate above behaviours:*** ***1-Bank 2-Client***

IIA-Interim summary on expected outcomes ***(Use template softcopy for extra space)***
Task (3) Analyze negotiation paradigm and potential clash.

[120] Interest-Based Negotiation (syr.edu)

Part (IIB) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 3 – EVALUATING NEGOTIATION POSITIONS

B – EVALUATE POSITION STRENGTH

How to fill in the template?

Note 1: "Q" = Facilitating Question

Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)

Note 3: Fill in the IIB-Interim summary

B1 Information strength

Strong: Having comprehensive data on the client's financial history, market trends, and regulatory changes.
Medium: Possessing general knowledge about the client's industry and basic financial information
Weak: limited understanding of the client's specific business model or market condition

Q-What's the level of Strength (choose 1)	**Distributive i.e. win-loss** **Time Tactics | Reveal information**	**Integrative i.e. win-win** **Communication Tactics | Reveal information | Promises | Concession**
Strong	Time-set the agenda Revealing information	Revealing information Communication-Active listening (~20% time)
Medium	Time-control schedule	Concession Promises
Weak	Time – delay	Communication -Active listening (~20% time)
	IIB1a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	*IIB1b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:* *1-Bank 2-Client*

B2 Place strength

Strong: Negotiating from a position where the bank is primary financier or has substantial leverage over the client
Medium: A balanced relationship where both parties have comparable bargaining power
Weak: The client has multiple financing options besides your bank, reducing your leverage

Q-What's the level of Strength (choose 1)	**Distributive i.e. win-loss** **Time Tactics | Authority**	**Integrative i.e. win-win** **Communication Tactics | Reveal information Concession**
Strong	Time-threat ultimatum	Revealing information
Medium	Time-set final date	Concession
Weak	Authority-limited authority	Communication-Active listening (~20% time)
	IIB2a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: **1-Bank 2-Client**	**IIB2b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:** **1-Bank 2-Client**

B3 Power factor

Strong: Holding a significant advantage like exclusive rights to a necessary resource or a dominant market position
Medium: Having a good reputation in the industry, or unique expertise that is valuable but not exclusive
Weak: Limited influence over the negotiation outcome, perhaps due to a lack of unique offerings or lower market standing

Q-What's the level of Strength (choose 1)	**Distributive i.e. win-loss** **HardTactics | Authority**	**Integrative i.e. win-win** **Communication Tactics | Reveal information Concession | Promises**
Strong	Hard tactics – attack Hard tactics – cut off ties	Promises
Medium	Authority – unauthorized negotiation	Communication-Active listening (~20% time)
Weak	Authority – limited authority	Concession
	IIB3a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	*IIB3b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:* **1-Bank 2-Client**

IIB-Interim summary on expected outcomes ***(Use template softcopy for extra space)***

Task (4) Evaluate negotiation strength.

<table>
<tr><td colspan="6">Part (IIC) ADAPTING BALANCED OFFER TO SITUATIONS</td></tr>
<tr><td rowspan="14">STEP 4 - ANTICIPATING CONCERNS AND OBJECTIONS</td><td colspan="5">C-ANTICIPATE CONCERNS/OBJECTIONS AND EVALUATE IMPACT ON THE BANK'S BALANCED OFFER</td></tr>
<tr><td colspan="5">How to fill in the template?
Note 1: "Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Add your response below each appropriate question chosen
Note 4: Fill in the IIC-interim summary</td></tr>
<tr><td colspan="2">Counterparts</td><td>Bank's Perspective
Concrete Substance</td><td>Client's Perspective
Concrete Substance</td><td>Bank & Client
Relationship</td></tr>
<tr><td rowspan="3">C1</td><td rowspan="3">Maximum Gain</td><td>Choose the approach per analysis in A:</td><td>Choose the approach per analysis in A:</td><td>Choose the approach per analysis in A:</td></tr>
<tr><td>IIC1a-Win-lose approach:
Q-What is the bank's maximum gain in this negotiation?</td><td>IIC1c-Win-lose approach:
Q-What might be the client's utmost desired outcome?</td><td rowspan="2">IIC1e-Trust & mutual agreement approach:
Q-What common ground can both parties find to foster a mutually beneficial relationship?</td></tr>
<tr><td>IIC1b-Trust & mutual agreement approach:
Q-How can the bank balance its interests with maintaining a long-term client relationship?</td><td>IIC1d-Trust & mutual agreement approach:
Q-How can the client's need be met while fostering a trusting relationship with the bank?</td></tr>
<tr><td rowspan="3">C2</td><td rowspan="3">Anticipated Concerns</td><td>Choose the approach and fill in the blanks.</td><td>Choose the approach and fill in the blanks.</td><td>Choose the approach and fill in the blanks.</td></tr>
<tr><td>IIC2a-Win-lose approach:
Q-What potential challenges or objections might the bank face, and how to turn this into opportunities.</td><td>IIC2c-Win-lose approach:
Q-What key concerns or hesitations might the client have regarding the bank's terms?</td><td rowspan="2">IC2e-Trust & mutual agreement approach:
Q-What shred concerns might both parties have and how can these be collaboratively addressed?</td></tr>
<tr><td>IIC2b-Trust & mutual agreement approach:
Q-What concerns might arise that could affect the long-term client relationship?</td><td>IIC2d-Trust & mutual agreement approach:
Q-How can the client's concerns be addressed to build trust in the negotiation process?</td></tr>
<tr><td rowspan="3">C3</td><td rowspan="3">Anticipated Objections?</td><td>Choose the approach and fill in the blanks.</td><td>Choose the approach and fill in the blanks.</td><td>Choose the approach and fill in the blanks.</td></tr>
<tr><td>IIC3a-Win-lose approach:
Q-What specific objections might the bank anticipate from the client and how can these be strategically countered?</td><td>IIC3c-Win-lose approach:
Q-What objections is the client likely to raise, and what are their underlying interests?</td><td rowspan="2">IIC3e-Trust & mutual agreement approach:
Q-How can both parties anticipate and manage objections to protect and enhance their relationship?</td></tr>
<tr><td>IIC3b-Trust & mutual agreement approach:
Q-How can the bank address objections in a way that preserves or enhances the relationship with the client?</td><td>IIC3d-Trust & mutual agreement approach:
Q-In what ways can the client's objections be resolved to strengthen trust and cooperation?</td></tr>
<tr><td colspan="5">IIC-Interim summary on expected outcomes (Use template softcopy for extra space)
Task (5) Anticipate concerns and evaluate their impact on the Bank's balanced offer.</td></tr>
</table>

Part (IID) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 5 – ASSESSING CLIENT' S COUNTEROFFER

D-ANTICIPATE THE CLIENT'S COUNTEROFFER AND EVALUATE THE BANK'S ADAPTATION

How to fill in the template?

Note 1: "Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the IID-Interim summary

	Q-What are the stand-views from Bank's Perspective	**Q- What are the stand-views from the Bank's Perspective**
	Fill in this column if the bank's approach is Distributive (win-loss)	**Fill in this column if the bank's approach is Integrative (win-win)**
D1	Compliance – code of ethics, inhouse code of conduct, sales compliance ***IID1a-Win loss approach – Fill in the blank below:***	Compliance – code of ethics, inhouse code of conduct, sals compliance ***IID1b-Trust & mutual agreement approach– Fill in the blank below:***
D2	Risk tolerance ***IID2a- Win loss approach – Fill in the blank below:***	Risk tolerance ***IID2b-Trust & mutual agreement approach– Fill in the blank below:***
D3	Application risk ***II31a- Win loss approach– Fill in the blank below:***	Application risk ***IID3b-Trust & mutual agreement approach - – Fill in the blank below:***
D4	Portfolio risk exposure ***IID4a- Win loss approach– Fill in the blank below:***	Portfolio risk exposure ***IID4b-Trust & mutual agreement approach – Fill in the blank below:***
D5	Revenue ***IID5a- Win loss approach– Fill in the blank below:***	Revenue ***IID5b-Trust & mutual agreement approach - Fill in the blank below:***
D6	Cost ***IID6a- Win loss approach– Fill in the blank below:***	Cost ***IID6b-Trust & mutual agreement approach – Fill in the blank below:***
D7	Others ***II71a- Win loss approach– Fill in the blank below:***	Trust ***IID7b-Trust & mutual agreement approach – Fill in the blank below:***
D8	Others ***IID8a- Win loss approach: – Fill in the blank below:***	Relationship ***IID8b-Trust & mutual agreement approach – Fill in the blank below:***

IID-Interim summary on expected outcomes ***(Use template softcopy for extra space)***
Task (6) Anticipate the client's counteroffer and evaluate Bank's adaptation.

Part (IIE) ADAPTING BALANCED OFFER TO SITUATIONS			
STEP 6 – EXIT STRATEGIY	**E-DEVELOP AND EXECUTE EXIT STRATEGY**		
	How to fill in the template? *Note 1:Q = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)* *Note 3: Fill in the IIE-interim summary* *Note 4: Fill in the III-Overall summary*		
	E1	Q-What will be the triggering event?	***IIE1a - Fill in the blank below:***
	E2	Q-What will be the timing of exit?	***IIE2b - Fill in the blank below:***
	E3	Q-What is the likelihood to execute exit plan	***IIE3c-Fill in the blank below***
	IIE-Interim summary on expected outcomes ***(Use template softcopy for extra space)*** *Task (7) Develop and execute exit strategy.*		

Part (III) Formulation of Negotiation Tactics **III-OVERALL SUMMARY - FORMULATION OF OVERALL NEGOTIATION TACTICS** *Task (8) Formulate overall negotiation tactics based on insights generated from above Task 1 – 7.*

Case Appendix 7

Pre-negotiation preparation – Response Template for Short Questions

Note to learners: (1) Copy and paste your responses in the interim summaries in Part (I) and (II) of the templates in Appendix 6 to the response templates below. (2) You will submit the completed response templates to the trainer/assessor for scoring (3) Completing the response templates will streamline your sharing and discussions in class.

Short Question 1 – Response Template

Task 1 – Capture insight on negotiation tactics – from analysis of the 10 key success drivers
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (I) skill assessment.

Short Question 2 – Response Template

Task 2 – Recommend/Structure the Bank's balanced offer
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task 3 – Analyze negotiation paradigm and potential clash
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task 4 – Evaluate negotiation strength
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Short Question 3 – Response Template

Task 5 – Anticipate concerns and evaluate their impact on the Bank's balanced offer
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task 6 – Anticipate the client's counteroffer and evaluate the Bank's adaptation
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task 7 – Develop exit strategy
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task 8 - Formulate overall negotiation tactics based on insights from above Task 1 - 7
Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Part (II) Interactive skill assessment (10 minutes)

Note to learners: (1) The trainer/assessor will be your negotiation counterpart in the skill assessment. The trainer/assessor will provide more information in the class. (2) It's essential that you analyze the negotiation circumstances, develop the negotiation tactics, and become familiar with the negotiation flow and the skills applied in each negotiation stage.

Case Appendix 8

Potential Counteroffers by Aviation Group Ltd
(For Trainers Only)

Note to trainers
Use this section to introduce unexpected elements to challenge the learners. These could be potential counteroffers or changes in Aviation Group's situation. Here are some suggestions.

Examples of situational changes for trainers' reference (choose one or many):

Extended government support: the government decided to extend a pandemic relief investment of USD2 billion for an additional 12 months to bolster Aviation Group's recovery efforts.

Fleet modernization grant: Aviation Group receives a substantial grant especially for fleet modernization, which alters its financial needs and priorities.

Recent profitability: Aviation Group reports profitability for the first time since 2020, indicating a stronger financial position than anticipated.

Alternative financing options: Aviation Group secures a commitment from another financial institution offering competitive financing terms, challenging the bank's proposed terms.

Case Appendix 9

Short Questions Response Plan and Score Registration Card (For Trainers Only)

Short Question (1) - Written Assessment – Response Plan and Scores (Maximum: 7 points)

Note to trainers: Learners should copy their responses in the template in Case Appendix 6

Task 1 – Capture insight on negotiation tactics – from analysis of the 10 key success drivers

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (1) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template.

Analysis – Bank's perspective	*Analysis – Client's perspective*	*Insight on negotiation*
The bank acknowledges uncertainties in the airline industry's recovery, particularly in the USA and Europe. Consequently, it prefers offering term loans with structured repayments, including balloon payment at maturity, aligning with market unpredictability. *On the other hand, the bank is experienced and resourceful in the airline industry, hence ready to have flexibility in the offer.*	*The client is determined to secure funding for fleet modernization despite constrained cash flow, with a strong preference for bank loans due to more favorable terms. The client's requirement for predictable, stable funding to ensure timely delivery of all 30 aircrafts aligns with the bank's expertise in aviation financing.*	*The negotiation approach centers on identifying common interests, with the bank's strategy focusing on secured, profitability financing arrangements. This aligns with the client's need for fleet modernization, fostering a long-term partnership. .*
Maximum points: 4	**Maximum points: 2**	**Maximum point: 1**

Short Question (2) - Written Assessment – Response Plan and Scores (Maximum: 7 points)

Note to trainers: Learners should copy their responses in the template in Case Appendix 6

Task 2 – Recommend/Structure the Bank's balanced offer

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (2) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template.

Proposes (i) structured asset finance, (ii)leveraging existing aircraft as collateral, with (iii) partial revenue channeled directly to escrowed account for regular repayment. The balanced bank offer should include (iv) periodic construction status reports for phased fund release and (v) regular aircraft valuation to maintain a loan-to-value ratio within 40% ensuring compliance with the bank's risk management policies.
Maximum point: 5

Task 3 – Analyze negotiation paradigm and potential clash

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (3) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template.

Analysis	*Insight on negotiation tactics*
-Both the bank and the client hail from European culture and large international corporations, indicating no significant cultural clash. -Both parties are industry veterans with assertive personalities, suggesting potential for direct confrontation during negotiation. -The client's ambition for fleet modernization funding could intensify competitive negotiation dynamics.	*-Initially, the bank may adopt a contributive and collaborative approach. However, the assertiveness of both parties indicates a likelihood of confrontations over disagreements in terms and conditions.* *-The bank should prioritize factual and data-drive discussions, steering negotiation towards mutually beneficial outcomes and aligning with best practices in corporate financing.*
Maximum points: 0.5	**Maximum points : 0.5**

Task 4 – Evaluate negotiation strength

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (4) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template.

Evaluation of negotiation strength	***Insight on negotiation tactics***
-Both the bank and the Client possess similar information strength in their respective areas, enabling a balanced exchange of facts and data -The bank, as the primary financier, holds a stronger position in terms of place strength, while the Client's good credit history and reputation provide leverage in attracting alternative financiers. -The negotiation style of both parties is likely to be assertive and fact-based	*-Despite the client's strong reputation, the Bank's extensive knowledge of the aviation industry and specific insights about the client confer a strategic advantage.* *-The bank should be prepared to adopt a firm stance on critical terms, transitioning from a collaborative approach to limited authority tactics if faced with excessive concession demands from the client. This approach will help maintain a balance between accommodating the client's needs and adhering to the bank's risk management policies.*
Maximum points: 0.5	**Maximum points: 0.5**

Short Question (3) - Written Assessment – Response Plan and Scores (Maximum: 7 points)

Note to trainers: Learners should copy their responses in the template in Case Appendix 6

Task 5 – Anticipate concerns and evaluate their impact on the Bank's balanced offer

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (5) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template.

Analysis	*Insight on negotiation tactics*
-The Client's concerns include high interest rates, stringent collateral requirements and inflexible repayment terms, which could impact their cash flow and financial health. *-The bank faces challenges in aligning its risk management strategies with the client's need for substantial funding and fleet expansion.* *-Common grounds for both parties include concerns about the volatile aviation industry and the sustainability of traffic recovery post-pandemic*	*-The bank should strategically address these concerns by emphasizing the mutual benefits of a structured finance solutions* *-During negotiation, focus on presenting a balanced approach that mitigates risks while accommodating the client's expansion goals* *-The bank should be prepared to discuss alternatives that respect both parties' interests, ensuring long-term relationship stability and trust.*
Maximum points: 0.5	**Maximum points: 0.5**

Task 6 – Anticipate the client's counteroffer and evaluate the Bank's adaptation

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (6) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template

Anticipated Client's counteroffer	**Client's counteroffer**
-The bank's offer of term loan with regular repayments, collateral valuation at 40% of the purchase price, and required guarantees from the parent company contrasts with the client's counteroffer, which includes overdraft facilities, premium interest rates, waived administration fees, and collateral valuation at market value	-In responding to the client's counteroffer, the bank needs to strike a balance between maximizing revenue and managing portfolio risk effectively. -The bank should consider the feasibility of the client's counteroffer in light of its risk assessment protocols and long-term relationship goals -Discussion should aim to find a middle ground that aligns with the bank's risk tolerance while accommodating the client's financial needs and cash flow constraints.
Maximum points: 0.5	**Maximum points: 0.5**

Task 7 – Develop exit strategy

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (7) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template

Analysis – showstoppers	*Insight on negotiation tactics*
-High interest rate and strict repayment terms -Collateral valuation and requirement on constant review of market value -Flexibility of different credit arrangement and growth support Exit strategy -to be triggered if the client demands exceed the bank's risk tolerance or if there is a notable deterioration in the client's financial health with the requested customized facility.	*-The exit strategy should be executed with professionalism, maintaining transparency and respect for the long-standing relationship with the client, and leaving room for future collaboration under more favorable conditions. The bank should convey its decision with clarify and empathy, ensuring that the door remains open for potential future negotiations.*
Maximum points: 0.5	**Maximum points: 0.5**

Task 8 - Formulate overall negotiation tactics based on insights from above Task 1 - 7

Please copy and paste your response from relevant section of the pre-negotiation template in Appendix 7 to earn points. It also helps you to prepare for Part (II) skill assessment.

Task (8) Note to trainers: the response is copied and pasted from the pre-negotiation preparation template

Analysis	**Insight on negotiation strategy**
-The bank's overarching strategy should balance flexibility with firmness, offering financing or leasing options tailored to the client's fleet modernization needs, while being open to slight adjustments in interest rates to accommodate the client's financial situation. *-The bank must adhere to its core risk management principles, particularly regarding repayment schedules and collateral requirements. Accepting shares as collateral, as proposed by the client, could be a strategic move to strike a balance between flexibility and risk management.*	***Through the negotiation process, the bank should (i) maintain transparent communication, clearly articulating its terms and being receptive to the (ii) client's counteroffers; yet the bank should be (iii) firm in its risk management stance. This approach aims to foster a (iv) mutually beneficial agreement while safeguarding the (v) bank's financial interests.***
Maximum points: 2	**Maximum points: 3**

Short Questions - Written Assessment – Score Registration Card (20%)

<u>Note to trainers</u>

Please refer to the participant's response on Task 1 to Task 8

Score the insights and negotiation tactics (based on learner's response to the pre-negotiation preparation template)				
Short Question	Tasks	Score per point	Maximum points	Points Obtained
1	1-Capture insight on negotiation tactics – from analysis of the 10 key success drivers	1	7	
2	2-Recommend/Structure the Bank's balanced offer	1	7	
	3-Analyze negotiation paradigm and potential clash	1		
	4-Evaluate negotiation strength	1		
3	5-Anticipate concerns and evaluate their impact on the Bank's balanced offer	1	7	
	6-Anticipate the client's counteroffer and evaluate the Bank's adaptation	1		
	7-Develop exit strategy	1		
	8-Formulate overall negotiation tactics based on insights from above Task 1 - 7	1		
Maximum Scores in Total			20	

Case Appendix 10

Long Questions Response Plan and Score Registration Card
(For Trainers Only)

Long Question (1) - Written Assessment – Response Plan (Maximum 8 points)

Note to trainers (1)The actual responses depend on the learners' analysis of the negotiation situation.(2) One point per response as the highlighted and circled samples below, bounded by maximum scores. (3) The responses in all interim summaries are scored separately as responses to short questions.

TEMPLATE – PRE-NEGOTATION PREPARATION				
Part (I) ALIGNING BALANCED OFFER TO NEGOTIATION'S KEY DRIVERS				
I	**STRATEGIC ALIGNMENT ON 6 KEY SUCCESS DRIVERS** 1-Long term interest[121]: In interest-based negotiations, the intent is to reach a mutually agreed acceptable outcomes, sometimes that is mutually beneficial to both parties. 2-Short term interest: Revealing from financial analysis, financial strength and credit strength analysis regarding the immediate business needs mutually beneficial to both parties. 3-Bottom line: The lowest acceptable point or the final offer a party is willing to accept in a negotiation. 4-BATNA: Best alternative to a negotiated agreement, defined as the most advantageous alternative that a bank can take if negotiation fail, and an agreement cannot be made 5-Option: Available choices parties might consider satisfying their interests, including conditions, contingencies and trades. 6-Concession: Adjusting on certain demands or positions to facilitate reaching an agreement			
	How to fill in the template? *Note 1: "Q" = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)* *Note 3: Fill in the I-interim summary*			
		Key Drivers	**Bank's Perspective**	**Client's Perspective**
STEP 1 - DEVELOPING A BALANCED OFFER (Complete 1 - 10)	1	Long term interest – strategic purpose	Q-Refer to the Bank's credit strategy, what are our goals for the future? How do this align with this negotiation?	Q-Refer to the client's business strategy, what are the client's long-term business objectives? How can we align with them?
		• Must have	***I1a-Fill in the blank below:***	***I1d-Fill in the blank below:*** -Secure financing for fleet renewal with favorable terms
		• Should have	***I1b-Fill in the blank below:*** -Seek a long-term partnership that supports the bank's growth and risk strategies.	***I1e-Fill in the blank below:***
		• Nice to have	***I1c-Fill in the blank below:***	***I1f-Fill in the blank below:***
		I1g-Remarks on bank-client gaps:		
	2	Short term interest – business need	Q-Refer to the Bank's business strategy, what immediate business needs must this negotiation address?	Q-Refer to the outcomes of the financial analysis on the client, what are the client's current financial priorities?
		• Must have	***I2a-Fill in the blank below:*** -Align with the Bank's credit strategy, ensuring profitability and minimizing risk exposure	***I2d-Fill in the blank below:*** -Acquire funding for the fleet renewal program, crucial for modernizing operations
		• Should have	***I2b-Fill in the blank below:*** -Immediate need to capitalize on the recovery aviation market, ensuring profitable and safe investment.	***I2e-Fill in the blank below:***
		• Nice to have	***I2c-Fill in the blank below:***	***I2f-Fill in the blank below:***
		I2g-Remarks on bank-client gaps:		

[121] Interest-based negotiation, Neil Katz & Kevin McNulty, 1995, [Interest-Based Negotiation (syr.edu)]

	3	Bottom line – the least we can accept	Q-Refer to inhouse analytics from similar cases for worst case, base case and best case, what is our minimum acceptable outcome from this negotiation?	Q-Refer to inhouse analytics on the same client for worst case, base case and best case, what might be the client's minimum expectations?
		• Financial	*I3a-Fill in the blank below.* -Ensure a secure and profitable return on investment	*I3c-Fill in the blank below:* -Obtain competitive financing rates with manageable repayment terms -Securing modernization without compromising financial health
		• Non-financial	*I3b-Fill in the blank below:* -Ensure leadership position in aviation financing in Southeast Asia -Maintaining long-term client relationship	*I3d-Fill in the blank below:* -N/A
		I3e-Remarks on bank-client gaps:		
	4	BATNA – (Best Alternative to a Negotiated Agreement)	Q-Refer to inhouse analytics of similar cases for BATNA in worst, base, and best BATNA, what is out best alternative?	Q-Refer to inhouse analytics on the same client's cases for BATNA in worst, base, and best BATNA, what is client's best alternative?
		Tangible	*I4a-Fill in the blank below:* -Exploring alternative investments in other aviation companies or industries	*I4c-Fill in the blank below:* -Considering other financing options, including bond markets or alternative lenders
		Intangible	*I4b-Fill in the blank below:* -Preserving reputation as a cautious lender	*I4d-Fill in the blank below:* -Maintaining market position and investor confidence
	5	Bank's options of offers and counteroffers (Minium 5 options)	Q-What's our base offer? Refer to inhouse analytics on the same client's cases	Q-What's the counteroffer? Refer to inhouse analytics on the same client's cases
		• Option 1	*I5a-Fill in the blank below:* -Offer structured finance	*I5f-Fill in the blank below:* -Explore various financing structures
		• Option 2	*I5b-Fill in the blank below:* -Offer leasing options	*I5g-Fill in the blank below:* -Consider leasing
		• Option 3	*I5c-Fill in the blank below:* -Offer phased funding	*I5h-Fill in the blank below:* -Consider traditional loan
		• Option 4	*I5d-Fill in the blank below:* -Positive and negative covenants to ensure financial health monitoring	*I5i-Fill in the blank below:* -Obtain funding from sales and lease back
		• Option 5	*I5e-Fill in the blank below:*	*I5j-Fill in the blank below:* -Flexible repayment terms
	6	Solutions/Concessions causing (or not) deviation	Q-What's our potential concession?	Q-What's the client's expected concession?
		Option 1	*I6a-Fill in the blank below:* -Adjustment in interest rate	*I6d-Fill in the blank below:* -Flexibility on collateral requirements
		Option 2	*I6b-Fill in the blank below:* -Adjustment in repayment terms	*I6e-Fill in the blank below:* -Financing terms e.g. interest
		Option 3	*I6c-Fill in the blank below:*	*I6f-Fill in the blank below:*

	STRATEGIC ALIGNMENT ON LEVERAGE COMPONENTS OF NEGOTIATION (B) **Smoothen the negotiation process leveraging on legitimacy, commitment, relationship and communication.** 7-Legitimacy: establish the fairness, process and outcomes and justifiability of the negotiation process and outcomes 8-Commitment: establish dedication to the negotiation process and adherence to any agreed terms 9-Relationship: establish the interpersonal and professional dynamics to maintain or enhance the relationship 10-Communication: establish effective exchange of information, proposals, and feedback throughout the negotiation			
	How to fill in the template? *Note 1:"Q" = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)*			
	7	**Key Drivers**	**Bank's Perspective**	**Client's Perspective**
		Legitimacy		
		• Strong	***I7a-Fill in the blank below:*** -As primary financier, we are in a privilege position to loan acquisition per long term relationship.	***I7c-Fill in the blank below:***
		• Weak	***I7b-Fill in the blank below:***	***I7d-Fill in the blank below:*** -The client at this stage is keen to have the lowest interest rate, longest tenor and largest loan amount. It does not necessarily justify for any legitimacy.
	8	Commitment		
		• Strong	***I8a-Fill in the blank below:*** -As leading bank in aviation loan, our commitment to partner with clients on their growth is strong, as the setup cost is relatively low to acquire a new client.	***I8c-Fill in the blank below:***
		• Weak	***I8b-Fill in the blank below:***	***I8d-Fill in the blank below:*** -The client at this stage is keen to have the lowest interest rate, longest tenor and largest loan amount. It does not necessarily justify for any legitimacy. A reliable bank with best offer is likely to acquire the client.
	9	Relationship		
		• Strong	***I9a-Fill in the blank below:*** -The bank has 60 years of long-term relationship with the client, evidence by itself on the strong relationship	***I9c-Fill in the blank below:*** -The client acknowledges the long-term relationship, so the Bank is the first to meet with it on potential financing arrangement.
		• Weak	***I9b-Fill in the blank below:***	**I9d-Fill in the blank below:**
	10	Communication		
		• Strong	***I10a-Fill in the blank below:*** -During pandemic, the bank's sales team keeps monitoring the industry and client account to spot any potential to collaborate with the client. There are regular visits to share industry information.	***I10c-Fill in the blank below:*** -Constant communication with Banks about is financial health during the pandemic and since the city resuming to normal post-pandemic
		• Weak	***I10b-Fill in the blank below:***	***I10d-Fill in the blank below:***

I-Interim summary ***(Use template softcopy for extra space)***

Task (1) Capture insight on negotiation tactics - from analysis of the 10 key success drivers

Task (2) Recommend/structure Bank's balanced offer.

Task (1)

Analysis – Bank's perspective	*Analysis – Client's perspective*	*Insight on negotiation*
The bank acknowledges uncertainties in the airline industry's recovery, particularly in the USA and Europe. Consequently, it prefers offering term loans with structured repayments, including balloon payment at maturity, aligning with market unpredictability.	*The client is determined to secure funding for fleet modernization despite constrained cash flow, with a strong preference for bank loans due to more favorable terms. The client's requirement for predictable, stable funding to ensure timely delivery of all 30 aircrafts aligns with the bank's expertise in aviation financing.*	*The negotiation approach centers on identifying common interests, with the bank's strategy focusing on secured, profitability financing arrangements. This aligns with the client's need for fleet modernization, fostering a long-term partnership. .*
Maximum points: 2	**Maximum points: 2**	**Maximum point: 1**

Task 2:

Proposes (i) structured asset finance, (ii)leveraging existing aircraft as collateral, with (iii) partial revenue channeled directly to escrowed account for regular repayment. The balanced bank offer should include (iv) periodic construction status reports for phased fund release and (v) regular aircraft valuation to maintain a loan-to-value ratio within 40% ensuring compliance with the bank's risk management policies.
Maximum point: 5

…

Long Question (2) - Written Assessment – Response Plan (Maximum 32 points)

Note to trainers (1)The actual responses depend on the learners' analysis of the negotiation situation.(2) One point per response as the highlighted and circled samples below, bounded by maximum scores. (3) The responses in all interim summaries are scored separately as responses to short questions.

Part (IIA) ADAPTING BALANCED OFFER TO SITUATION

II — A-NEGOTIATION PARADIGM

STEP 2 – EVALUATING NEGOTATION PARADIGM

How to fill in the template?

Note 1: "Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the IIA-interim summary

IIA-Fill in the information.

Counterpart	Name	Dept	Title	Decision Authority
Bank	Mr. John S.	Credit	Senior RP	High & adhere to guideline
Client	Ms. Jane J.	Finance	CFO	High & approval from board needed

…

	Attributes	Q-Which party adopts the Distributive Paradigm i.e. win-loss	Q-Which party adopts the Integrative Paradigm i.e. win-win
A1	Anticipated Paradigm	Position-based Distributive i.e. win-loss	Interest-based Integrative i.e. win-win
		IIA1a-Circles the party(s) likely to demonstrate the above paradigm: ***1-Bank*** ***2-Client***	***IIA1b-Circle the party(s) likely to demonstrate the above paradigm:*** ***1-Bank*** ***2-Client***
A2	Anticipated behavioural clashes	Factors to higher propensity for position-based/distributive paradigm Personality: competitive Gender: assertive Culture: distinctive norm	Factors to higher propensity for interest-based/integrative paradigm Propensity for Personality: withdrawing Gender: collaborative Culture: diversified
		IIA2a-Circles the party(s) likely to demonstrate above behaviours: ***1-Bank*** ***2-Client***	***IIA2b-Circle the party(s) likely to demonstrate the above behaviours:*** ***1-Bank*** ***2-Client***
A3	Consider ethical boundary	Unethical negotiation -Manipulative -Coercive	Unethical negotiation -excessive concession
		IIA3a-Circles the party(s) likely to demonstrate above behaviours: ***1-Bank*** ***2-Client***	***IIA3b-Circles the party(s) likely to demonstrate above behaviours:*** ***1-Bank*** ***2-Client***

IIA-Interim summary ***(Use template softcopy for extra space)***

Task (3) Analyze the negotiation paradigm and potential clash.

Analysis	*Insight on negotiation tactics*
-Both the bank and the client hail from European culture and large international corporations, indicating no significant cultural clash. -Both parties are industry veterans with assertive personalities, suggesting potential for direct confrontation during negotiation. -The client's ambition for fleet modernization funding could intensify competitive negotiation dynamics.	*-Initially, the bank may adopt a contributive and collaborative approach. However, the assertiveness of both parties indicates a likelihood of confrontations over disagreements in terms and conditions.* *-The bank should prioritize factual and data-drive discussions, steering negotiation towards mutually beneficial outcomes and aligning with best practices in corporate financing.*
Maximum points: 0.5	**Maximum points : 0.5**

…

…

Part (IIB) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 3 – EVALUATING NEGOTIATION POSITIONS

B – POSITION STRENGTH

How to fill in the template?

Note 1: "Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the IIB- interim summary

B1 Information strength

Strong: Having comprehensive data on the client's financial history, market trends, and regulatory changes.
Medium: Possessing general knowledge about the client's industry and basic financial information
Weak: limited understanding of the client's specific business model or market condition

Strength (choose 1)	**Distributive i.e. win-loss** Time Tactics | Reveal information	**Integrative i.e. win-win** Communication Tactics | Reveal information | Promises | Concession
Strong	Time-set the agenda Revealing information	**Revealing information** **Communication--Active listening (~20% time)**
Medium	**Time-control schedule**	Concession Promises
Weak	Time – delay	Communication -Active listening (~20% time)
	IIB1a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	*IIB1b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:* *1-Bank 2-Client*

B2 Place strength

Strong: Negotiating from a position where the bank is primary financier or has substantial leverage over the client
Medium: A balanced relationship where both parties have comparable bargaining power
Weak: The client has multiple financing options besides your bank, reducing your leverage

Strength (choose 1)	**Distributive i.e. win-loss** Time Tactics | Authority	**Integrative i.e. win-win** Communication Tactics | Reveal information Concession
Strong	Time-threat ultimatum	Revealing information
Medium	**Time-set final date**	**Concession**
Weak	Authority-limited authority	Communication-Active listening (~20% time)
	IIB2a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	*IIB2b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:* *1-Bank 2-Client*

B3 Power factor

Strong: Holding a significant advantage like exclusive rights to a necessary resource or a dominant market position
Medium: Having a good reputation in the industry, or unique expertise that is valuable but not exclusive
Weak: Limited influence over the negotiation outcome, perhaps due to a lack of unique offerings or lower market standing

Strength (choose 1)	**Distributive i.e. win-loss** HardTactics | Authority	**Integrative i.e. win-win** Communication Tactics | Reveal information Concession | Promises
Strong	Hard tactics – attack Hard tactics – cut off ties	**Promises**
Medium	**Authority – unauthorized negotiation**	Communication-Active listening (~20% time)
Weak	Authority – limited authority	Concession
	IIB3a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	**IIB3b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:** **1-Bank 2-Client**

IIB-Interim summary ***(Use template softcopy for extra space)***

Task (4) Evaluate negotiation strength

Evaluation of negotiation strength	*Insight on negotiation tactics*
-Both the bank and the Client possess similar information strength in their respective areas, enabling a balanced exchange of facts and data -The bank, as the primary financier, holds a stronger position in terms of place strength, while the Client's good credit history and reputation provide leverage in attracting alternative financiers. -The negotiation style of both parties is likely to be assertive and fact-based	*-Despite the client's strong reputation, the Bank's extensive knowledge of the aviation industry and specific insights about the client confer a strategic advantage.* *-The bank should be prepared to adopt a firm stance on critical terms, transitioning from a collaborative approach to limited authority tactics if faced with excessive concession demands from the client. This approach will help maintain a balance between accommodating the client's needs and adhering to the bank's risk management policies.*
Maximum points: 0.5	**Maximum points: 0.5**

…

Part (IIC) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 4 - ANTICIPATING CONCERNS AND OBJECTIONS

C-CONCERNS & OBJECTIONS

How to fill in the template?

Note 1: "Q" = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Add your response below each appropriate question chosen
Note 4: Fill in the IIC-interim summary

Counterparts		Bank's Perspective Concrete Substsance	Client's Perspective Concrete Substance	Bank & Client Relationship
C1	Maximum Gain estimated	**Choose the approach per analysis in A:**	**Choose the approach per analysis in A:**	**Choose the approach per analysis in A:**
		***IIC1a-Win-lose approach*:** Q-What is the bank's maximum gain in this negotiation?	***IIC1c-Win-lose approach:*** Q-What might be the client's utmost desired outcome? -Seeks substantial funding for fleet expansion but maintaining financial health	***IIC1e-Trust & mutual agreement approach:*** Q-What common ground can both parties find to foster a mutually beneficial relationship? -Both sides are keen to identify a financing structure that supports expansion of fleet and align with the bank's risk management strategies.
		IIC1b-Trust & mutual agreement approach: Q-How can the bank balance its interests with maintaining a long-term client relationship? -Maximum gain lies in securing a profitable, low risk financing arrangement i.e. collateral and/or guarantee will help.	***IIC1d-Trust & mutual agreement approach:*** Q-How can the client's need be met while fostering a trusting relationship with the bank	
C2	Anticipated concerns	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**
		IIC2a-Win-lose approach: Q-What potential challenges or objections might the bank face, and how to turn this into opportunities.	***IIC2c-Win-lose approach:*** Q-What key concerns or hesitations might the client have regarding the bank's terms? -high interest rates, stringent collateral requirements, and inflexible repayment terms impacting their cash flow.	***IC2e-Trust & mutual agreement approach:*** Q-What shred concerns might both parties have and how can these be collaboratively addressed? -Share the concern about high industry volatility and uncertainty about

<table>
<tr><td></td><td></td><td></td><td>IIC2b-Trust & mutual agreement approach:
Q-What concerns might arise that could affect the long-term client relationship?
-Direct challenge about the post-pandemic recovery of industry, the aggressive expansion plan while still owing government money.</td><td>IIC2d-Trust & mutual agreement approach:
Q-How can the client's concerns be addressed to build trust in the negotiation process?</td><td>sustainability of traffic recovery.</td></tr>
<tr><td></td><td>C3</td><td>Anticipated objections</td><td>Choose the approach and fill in the blanks.</td><td>Choose the approach and fill in the blanks.</td><td>Choose the approach and fill in the blanks.</td></tr>
<tr><td></td><td></td><td></td><td>IIC3a-Win-lose approach:
Q-What specific objections might the bank anticipate from the client and how can these be strategically countered?</td><td>IIC3c-Win-lose approach:
Q-What objections is the client likely to raise, and what are their underlying interests?
-Rigid term payment despite its substantial initial investment in purchasing the aircraft.</td><td rowspan="2">IIC3e-Trust & mutual agreement approach:
Q-How can both parties anticipate and manage objections to protect and enhance their relationship?

Focus on long term relationship stability.</td></tr>
<tr><td></td><td></td><td></td><td>IIC3b-Trust & mutual agreement approach:
Q-How can the bank address objections in a way that preserves or enhances the relationship with the client?
-Consistency reveal facts and data from expertise third parties on market value of collaterals, interest rate trends, funding cost and overhead cost.</td><td>IIC3d-Trust & mutual agreement approach:
Q-In what ways can the client's objections be resolved to strengthen trust and cooperation?</td></tr>
</table>

IIC-INTERIM SUMMARY ***(Use template softcopy for extra space)***

Task (5) Anticipate concerns and evaluate their impact on the Bank's balanced offer

Analysis	*Insight on negotiation tactics*
-The Client's concerns include high interest rates, stringent collateral requirements and inflexible repayment terms, which could impact their cash flow and financial health. *-The bank faces challenges in aligning its risk management strategies with the client's need for substantial funding and fleet expansion.* *-Common grounds for both parties include concerns about the volatile aviation industry and the sustainability of traffic recovery post-pandemic*	*-The bank should strategically address these concerns by emphasizing the mutual benefits of a structured finance solutions* *-During negotiation, focus on presenting a balanced approach that mitigates risks while accommodating the client's expansion goals* *-The bank should be prepared to discuss alternatives that respect both parties' interests, ensuring long-term relationship stability and trust.*
Maximum points: 0.5	**Maximum points: 0.5**

Part (IID) ADAPTING BALANCED OFFER TO SITUATIONS			
STEP 5 – ASSESSING CLIENT' S COUNTEROFFER	**D-IMPACT OF CLIENT'S COUNTEROFFER**		
	How to fill in the template? *Note 1: "Q" = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)* *Note 3: Fill in the IID-interim summary*		
		Bank's Perspective	**Bank's Perspective**
		Distributive (win-loss)	**Integrative (win-win)**
	D1	Compliance – code of ethics, inhouse code of conduct, sales compliance ***IID1a-Win loss approach-Fill in the blank below*** **-Ensuring all terms meet regulatory and ethical standards without compromising the bank's policy**	Compliance – code of ethics, inhouse code of conduct, sales compliance ***IID1b-Trust & mutual agreement approach– Fill in the blank below:*** **- Collaborative approach to meet compliance while accommodating client's needs.**
	D2	Risk tolerance ***IID2a- Win loss approach – Fill in the blank below:*** **- Adherence to strict risk assessment protocols**	Risk tolerance ***IID2b-Trust & mutual agreement approach– Fill in the blank below:*** -Collateral LTV still below credit guideline but the loan repayment rate will not match with the depreciation rate
	D3	Application risk ***II31a- Win loss approach– Fill in the blank below:*** **- Rigorous evaluation of Aviation Group's application to minimize risk**	Application risk ***IID3b-Trust & mutual agreement approach - – Fill in the blank below:*** -OD arrangement without periodic fixed repayment is undesirable during this slow recovery period.
	D4	Portfolio risk exposure ***IID4a- Win loss approach– Fill in the blank below:*** **- Maintaining a conservative portfolio risk profile**	Portfolio risk exposure ***IID4b-Trust & mutual agreement approach – Fill in the blank below:*** -The total asset need is about 20% of its existing aircraft portfolio. The significant fixed investment relative to the uncertain aviation industry recovery post-pandemic and anticipated depression in advanced economy, makes our loan portfolio risk increases.
	D5	Revenue ***IID5a- Win loss approach– Fill in the blank below:*** **- Maximizing revenue from the deal.**	Revenue ***IID5b-Trust & mutual agreement approach - Fill in the blank below:*** -The client is ready to accept premium pricing if more flexible form of credit facilities could be arranged. The counteroffer increases bank revenue but the portfolio risk is significant.
	D6	Cost ***IID6a- Win loss approach– Fill in the blank below:*** **- Minimizing cost associated with the deal**	Cost ***IID6b-Trust & mutual agreement approach – Fill in the blank below:*** -Capital cost for aircraft financing is higher than other loans. The client is ready to pay premium pricing for flexibility repayment arrangement, so there is not much concern about cost. However, the default risk

			increases given the uncertain cash flow from the client's business.
	D7	Others ***II71a- Win loss approach– Fill in the blank below:***	Relationship ***IID8b-Trust & mutual agreement approach – Fill in the blank below:*** - Build trust and strengthening the relational through transparent and fair negotiation
	D8	Others ***IID8a- Win loss approach: – Fill in the blank below:***	Relationship ***IID8b-Trust & mutual agreement approach – Fill in the blank below:*** -Insignificant impact on relationship, even the counteroffer is not accepted by the Bank.

IID-INTERIM SUMMARY ***(Use template softcopy for extra space)***

Task (6) Anticipate the client's counteroffer and the Bank's adaptation

Anticipated Client's counteroffer	**Client's counteroffer**
-The bank's offer of term loan with regular repayments, collateral valuation at 40% of the purchase price, and required guarantees from the parent company contrasts with the client's counteroffer, which includes overdraft facilities, premium interest rates, waived administration fees, and collateral valuation at market value	-In responding to the client's counteroffer, the bank needs to strike a balance between maximizing revenue and managing portfolio risk effectively. -The bank should consider the feasibility of the client's counteroffer in light of its risk assessment protocols and long-term relationship goals -Discussion should aim to find a middle ground that aligns with the bank's risk tolerance while accommodating the client's financial needs and cash flow constraints.
Maximum points: 0.5	**Maximum points: 0.5**

STEP 6 – EXIT STRATEGIY			
	Part (IIE) ADAPTING BALANCED OFFER TO SITUATIONS		
	How to fill in the template? *Note 1: "Q" = Facilitating Question* *Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)* *Note 3: Fill in the IIE-interim summary* *Note 4: Fill in the III-overall summary*		
	E1	Triggering event	***IIE1a - Fill in the blank below*** Initiate exit if the client (1) consistently demands terms that significantly exceed the bank's risk tolerance or (2) if there is notable deterioration in the client's financial health or market position.
	E2	Timing of exit	***IIE2b - Fill in the blank below*** Ensure a graceful exit by (1) communicating the decision transparently, (2) maintaining respect for the long-standing relationship, and (3) expressing openness to future collaboration under different circumstances.
	E3	Likelihood to execute exit plan	***IIE3c-Fill in the blank below*** The initial assessment is that (1) the Bank is in a stronger negotiation position (2) (information, resources, and relationship), hence likely to achieve a deal and low likelihood of executing exit plan.

IIE-INITERIM SUMMARY ***(Use template softcopy for extra space)***

Task (7) Develop and execute exit strategy

Analysis – showstoppers	*Insight on negotiation tactics*
-High interest rate and strict repayment terms -Collateral valuation and requirement on constant review of market value -Flexibility of different credit arrangement and growth support Exit strategy -to be triggered if the client demands exceed the bank's risk tolerance or if there is a notable deterioration in the client's financial health with the requested customized facility.	*-The exit strategy should be executed with professionalism, maintaining transparency and respect for the long-standing relationship with the client, and leaving room for future collaboration under more favorable conditions. The bank should convey its decision with clarify and empathy, ensuring that the door remains open for potential future negotiations.*
Maximum points: 0.5	**Maximum points: 0.5**

OVERALL SUMMARY - FORMULATION OF OVERALL NEGOTIATION TACTICS

Task (8) Formulate overall negotiation tactics based on insights generated from the above Task 1 – 7

Analysis	**Insight on negotiation strategy**
-The bank's overarching strategy should balance flexibility with firmness, offering financing or leasing options tailored to the client's fleet modernization needs, while being open to slight adjustments in interest rates to accommodate the client's financial situation. *-The bank must adhere to its core risk management principles, particularly regarding repayment schedules and collateral requirements. Accepting shares as collateral, as proposed by the client, could be a strategic move to strike a balance between flexibility and risk management.*	***Through the negotiation process, the bank should (i) maintain transparent communication, clearly articulating its terms and being receptive to the (ii) client's counteroffers; yet the bank should be (iii) firm in its risk management stance. This approach aims to foster a (iv) mutually beneficial agreement while safeguarding the (v) bank's financial interests.***
Maximum points: 2	**Maximum points: 3**

Long Questions - Written Assessment – Score Registration Card

Note to trainers

Trainers may refer to participants' responses in their completed templates in Case Appendix 6

Score the analysis (based on learner's response to the pre-negotiation preparation template)

Question	Part	Task/Number	Point per each response	Maximum points	Points Obtained
1	I	1-Long term interest-Strategic purpose	1	8	
		2-Short term interest-Business needs	1		
		3-Bottom line-the least we can accept	1		
		4-BATNA	1		
		5-Solutions-Options Counteroffers	1		
		6-Solutions/concessions causing (or not) deviation	1		
		7-Key drivers	1		
		8-Commitment	1		
		9-Relationship	1		
		10-Communication	1		
2	IIA	A1-Anticipated paradigm	1	8	
		A2-Anticipated behavioural clashes	1		
		A3-Consider ethical boundary	1		
	IIB	B1-Information strength	1		
		B2-Place strength	1		
		B3-Power factor	1		
3	IIC	C1-Maximum gain estimated	1	8	
		C2-Anticipated concerns	1		
		C3-Anticipated objections	1		
4	IID	D1-Compliance	1	8	
		D2-Risk tolerance	1		
		D3-Application risk	1		
		D4-Portfolio risk exposure	1		
		D5-Revenue	1		
		D6-Cost	1		
		D7-Others	1		
		D8-Others	1		
5	IIE	E1-Triggering event	1	8	
		E2-Timing of exit	1		
		E3-Likelihood to execute exit plan	1		
	Maximum scores in Total			40	

Case Appendix 11

Case-Based Question, Response Plan, and Score Registration Card
(For Trainers Only)

Case-based Question – Dialogue Assessment – During Negotiation (Maximum 40 points)

Note to trainers
Follow the steps below to complete the assessment.

Step 1- Select and start the dialogue with sample scripts

-The trainer/assessor acts the client's role in the dialogue assessment

-The dialogue flow design aligns with the ILO, and trainer/assessor may refer to the corresponding assessment checklist for easy scoring.

-The dialogues during the assessment need not be continuous nor follow a linear progression

-The trainer/assessor focuses on evaluating the learner's competency to respond to the selected client's scripts

-Dialogues choice (1) and (2) below are sample scripts developed based on the ILO related to negotiation. The trainer may develop other sample scripts.

Step 2 – Utilize the sample assessment checklist

-The checklist following the dialogue choices provides a structured framework for evaluating the learners' negotiation skills based on specific criteria and stages.

Step (1) Select and start the dialogue

Dialogue choice (1)

The following part numbers correspond to the same part numbers in the pre-negotiation preparation template Part (I) Context: Trainer takes the distributive approach; RP takes the integrative approach					
Part (I)	Topic	Trainer's opening script as client (suggested to trainer/assessor)	Learner's potential response script (for reference and scoring of trainer/assessor)	Negotiation stage (for reference of trainer/ assessor)	Assess the learner's skills (Scored points for reference of trainer/ assessor)
1	Long-term interest – strategic purpose	Our long-term strategy focuses on expanding our market presence and fleet modernization. We need a financial partner who understands and aligns with our vision and can offer terms that facilitate this growth.	Recognizing your long-term strategy, our bank is prepared to offer strategic financing solutions that support your fleet modernization and market expansion goals. Our partnership will provide both immediate and long-term financial support, tailored to align with your vision	Frame the negotiation	**To influence** -setting objective and boundary -educate the customer -frequent updating client understanding -have feedback loop to invite queries
2	Short-term interest – business needs	In the short term, our priority is securing funding for immediate improvement, we're looking for financial solutions that's both quick and beneficial for our fleet expansion.	We understand the immediacy of your needs. Our bank proposes swift financing solutions that not only facilitate your fleet expansion but also ensure mutual profitability and risk management, aligning with your short-term priorities.	Frame the negotiation	**To influence** -setting objective and boundary -educate the customer -frequent updating client understanding -have feedback loop to invite queries
3.	Bottom-line	We have a clear bottom line in these negotiations. We cannot go beyond a specific interest rate and repayment term. Anything above that would be unacceptable	We respect your bottom-line constraints and have structured our offer to remain within those parameters, ensuring a secure and profitable investment for both parties. Let's discuss how this aligns with your expectations and find a common ground.	Frame the negotiation	**To influence** -setting objective and boundary -educate the customer -frequent updating client understanding -have feedback loop to invite queries
4	BATNA	If we can't reach an agreement, we have other financing options. However, we prefer working with your bank, given our history.	Your preference for our bank is valued. Let's navigate towards an agreement that is more advantageous than your alternative options, capitalizing on our longstanding relationship and our comprehensive understanding of your needs.	Frame the negotiation	**To influence** -setting objective and boundary -educate the customer -frequent updating client understanding -have feedback loop to invite queries
5	Solutions – Options	We're open to various financing structures. What can you offer that's different from the conventional loan models?	In response to your openness, we are offering diverse financing structures, including structured finance and leasing options. These alternatives are designed to cater your unique conditions.	Offering value	**To persuade** -offering balanced recommendation -offering MESO
6	Solution concession	We expect certain concessions from your side, especially regarding interest rates and collateral requirements.	We are willing to engage in discussions about potential concessions. Any adjustments will be carefully considered to ensure they are in line with our risk management framework and bank policies, aiming for mutually beneficial agreement.	Adapting to solutions	**To facilitate** -having active listening -Demonstrating empathy -Assessing counter-offer

Dialogue choice (2)

The following part numbers correspond to the same part numbers in the pre-negotiation preparation template Part (II) Context: Trainer takes the distributive approach; RP takes the integrative approach					
Part (II)	Topic	Trainer's opening script as client (suggested to trainer/assessor)	Learner's potential response script (for reference and scoring of trainer/assessor)	Negotiation stage (for reference of trainer/ assessor)	Assess the learner's skills (Scored points for reference of trainer/ assessor)
A1-A3	Negotiation paradigm	We're very straight forward in our approach, we want the best deal, plain and simple. What's your approach?	Our approach is integrative, aiming for a balanced deal that brings long-erm value to both sides. We focus on understanding your goals and aligning them with our risk management strategies to create a mutual beneficial solution.	Frame the negotiation	**To influence** -setting objective and boundary -educate the customer -frequent updating client understanding -have feedback loop to invite queries
B1 – B3	Position strength	We have multiple financing options. Your offer needs to be competitive for us to consider.	Acknowledging your advantageous position, our offer is created to be competitive and tailored to your specific needs, combining comprehensive market insights with a deep understanding of your financial goals.	Offer value	**To persuade** -Offering balanced recommendation -Offering MESO
C1 – C3	Anticipating Concerns and objections	We have concerns about high interest rates and inflexibility in terms of payments. How do you address these?	We recognize these concerns and have structured our offer to provide competitive rates and flexible payment options. Our aim is to accommodate your financial health while aligning with our bank's risk management policies.	Adapting to situations	**To facilitate** -Having active listening -Demonstrating empathy -Assessing counteroffer
D1 – D8	Assessing Client' s counteroffer	Our counteroffer includes a request for lower interest rates and more flexible terms. What's your take?	We will closely review your counteroffer. Our goal is to negotiate terms that are feasible for both parties, potentially exploring additional collateral options to accommodate greater flexibility in payment terms.	Gaining Commitment	**To facilitate** -Making promises -Giving concessions
E1 – E3	Exit strategy	If our demand exceeds your limits, we may need to look elsewhere. We have our exit thresholds.	We respect your thresholds and are committed to finding common ground within our risk tolerance. Our focus is to reach a mutually agreeable solution that benefit both parties without compromising our core policies.	Next steps to elevate chance to closing deals	**To facilitate** -Confirming agreement -Confirming terms and conditions -Confirming needed documents
F	Recap of overall strategy	In summary, we need a deal that supports our immediate and long-term goals, with specific terms and concessions.	Our overarching strategy is to offer a flexible yet structured financing solution, focusing on transparent negotiation and adherence to risk management. We aim to provide a deal that aligns with your goals and our bank's policies, fostering a long-term partnership.	Frame the negotiation (for the next stage)	To influence -setting objective and boundary -educate the customer -frequent updating client understanding -have feedback loop to invite queries

Step 2 – Use the assessment checklist below to score the dialogues

Note to trainers

Please note that the checklist below is compiled to facilitate the scoring of learner's response throughout the complete stages of negotiation.

Stage-1 Framing the negotiation
Stage-2 Offering value
Stage-3 Adapting to situations
Stage-4 Gaining commitment
Stage-5 Closing the deal or next steps to closing the deal

Skills in different negotiation stages

Stage-1 Framing the negotiation	**Points obtained maximum points: 4**
[ ] Objective setting and boundary definition (1 point) ***-Clearly defines objectives for negotiation*** ***-Establishes boundaries and limits effectively*** [ ] Educating the customer (1 point) ***-Demonstrates knowledge of client's needs and aligns solutions accordingly*** ***-Provides clear, relevant, and informative insights*** [ ] Updating client understanding (1 point) ***-Regularly checks and updates client understanding*** ***-Adjusts approach based on client feedback*** [ ] Feedback loop and queries (1 point) ***-Encourages and effectively handles client queries*** ***-Uses feedback to refine negotiation strategy***	

Stage-2 Offering value	**Points obtained maximum points: 6**
[ ] Balanced Recommendation (3 point) ***-Offers solutions that balance client needs with bank policies*** [ ] Offering Multiple Equivalent Simultaneous Offers (MESO) (3 point) ***-Presents multiple viable options to the client*** ***-Demonstrates flexibility and creativity in solutions***	

Stage-3 Adapting to situations	Points obtained maximum points: 4
[ ] Active listening (0.5 point) *-Shows understanding of client concerns through active listening* [ ] Demonstrating empathy (0.5 point) *-Connects with client's concerns and exhibits empathy* [ ] Assessing counteroffer (2 point) *-Effectively evaluates and responds to client's counteroffers*	

Stage-4 Gaining commitment	Points obtained maximum points: 4
[ ] Making promises and giving concessions (4 points) *-Balances concessions with bank's interest* *-Make promises that are aligned with capabilities*	

Stage-5 Closing the deal or next step to closing the deal	Points obtained maximum points: 4
[ ] Confirming agreement (0.5 point) *-Ensures clarity and mutual understanding of the agreement* [ ] Demonstrating terms and conditions (0.5 point) *-Clarifies and agrees on specific terms and conditions* [ ] Confirming needed documents (2.0 point) *-Ensures all necessary documentation is understood and prepared*	

Part (2) Overall negotiation performance

Adherence to negotiation process	Points obtained maximum points: 18
[ ] Adherence to negotiation process (6 points) *-Consistently follows the structured negotiation* [ ] Communication and Transparency (6 points) *-Maintain clear, transparent, and effective communication throughout* [ ] Strategic alignment with bank policies (6 points) *-Align negotiation strategies with bank's policies and risk management*	

Step (2) Transpose the scores into the matrix and calculate the total

Skills	Points for each negotiation stage				
	Stage 1 Framing the negotiation	**Stage 2 Offering value**	**Stage 3 Adapting to situations**	**Stage 4 Gaining commitment**	**Stage 5 Closing the detail**
Interactive skills along different negotiation stages					
To influence[122] -objective setting and boundary definition -educating the customer -updating client understanding -feedback loop and queries	Max: 4 Actual: __	-	-	-	-
To persuade -Balanced recommendation -Offering multiple equivalent offers	-	Max:6 Actual:__	-	-	-
To facilitate -Active listening -Demonstrating empathy -Assessing counteroffer	-	-	Max:4 Actual: __	-	-
To facilitate -Making promises -Giving concessions	-	-	-	Max:4 Actual:__	-
To facilitate[123] -Confirming agreement -Demonstrating terms and conditions -Confirming needed documents	-	-	-	-	Max:4 Actual:__
Sub-total	Max:4 Actual:__	Max:6 Actual: __	Max:4 Actual: __	Max:4 Actual: __	Max:4 Actual: _
				Subtotal (A)	Max:22 Actual:__
Overall negotiation skills					
Adherence to negotiation process -Consistently follows the structured negotiation					Max:6 Actual:__
Communication and Transparency -Maintain clear, transparent, and effective communication throughout					Max:6 Actual:__
Strategic alignment with bank policies -Align negotiation strategies with bank's policies and risk management					Max:6 Actual:__
				Subtotal (B)	Max:18 Actual:___
				Total (A) + (B)	Max:40 Actual:__ ___

[122] Refer to presentation skills regarding managing expectation.
[123] Refer to presentation skills regarding closing deal

Appendix 8A – Sample - Checklist for Pre-consultation Preparation

CHECKLIST FOR PRE-CONSULTATION PREPARATION - A CONCISE GUIDE FOR EFFECTIVELY PREPARING FOR CLIENT CONSULTATION.

Part (1) Know your customer
Part (2) Understand the business model
Part (3) Understand the value chain

Part (1) Know your customer

1.FINANCIAL ANALYSIS

Understand and evaluate the Accounting Concepts Applied in the Client
[ ] Review dual transaction basics, noting the off-balance sheet transactions
[ ] Understand the application status of the accounting standards
[ ] Examine accounting policies in the corporate financial reports
[ ] Assess quality and limitation of financial statements
[ ] Investigation on initial overall impression from financial statements

Conduct Financial Ratios Analysis
[ ] Retrieve and analyze financial ratios

2.FINANCIAL STRENGTH

Conduct Critical Analysis of Financial Statement (Internal Factors)
[ ] Compare financial ratios with industry norms

Conduct Critical Analysis of Financial Statements (External Factors)
[ ] Review articulation of external risk factors to historical financial performance across different industry cycles

3.CREDIT RISK ANALYSIS

Conduct Budget and Pro-Forma Analysis
[ ] Analyse to help clients to identify client's purpose and objectives for loan demands
[ ] Assess cash flow gaps and non-cash items in budgets

Part (2) Understand the Business Model

1.FINANCIAL ANALYSIS

Obtain Qualitative Financial Information and associated with financial ratios
[ ] Link qualitative aspects with financial data (e.g. strategic direction, business initiatives)

Analyse Key Business Drivers Analysis
[ ] Identify and analyse key business drivers and their coherence with business direction

2.FINANCIAL STRENGTH

Conduct Critical Analysis of Financial Statements (Internal Critical Risk Factors)
[ ] Analyse financial leveraging and operational risks
[ ] Study the implications from cash flow analysis
[ ] Evaluate the corporation's cash flows and credit repayments

3.CREDIT RISK ANALYSIS

Conduct Budget and Pro-Forma Analysis (Business Value Calculation)
[ ] Apply adequate methodologies to estimate the business or project value, e.g. NPV

Conduct Quantitative Analysis and Risk Assessment (Business Model Achievability)
[ ] Assess the risk impact of qualitative and quantifiable risk factors on business model achievability

Part (3) Understand the Value Chain

1.FINANCIAL ANALYSIS

Analyse Key Business Drivers to Understand the Value Chain of the Business to have holistic view
[ ] Analyse the value chain of the business to adopt a holistic consideration to assess risks
[ ] Evaluate the business model coherence with the value chain

2.FINANCIAL STRENGTH

Conduct Critical Analysis of Financial Statement with Site Visits
[ ] Conduct site visits with a checklist to validate operational aspects

Conduct Critical Analysis of Financia Statement to Evaluate Business Model
[ ] Quantitative analysis on business models to supplement financial analysis

3.CREDIT RISK ANALYSIS

Conduct Quantitative Analysis and Risk Assessment (Value Chain Sustainability)
[ ] Assess impact of qualitative and quantifiable risk factors to value chain sustainability

Structure credit facility (knowing Impact on balance sheet)
[ ] Analyse the credit facilities impact on the balance sheet in base case, stress and default situation
[ ] Evaluate and recommend tailor-made financial package option

Part (4) Questions to clarification with clients: (i) To fill up gaps between coherence of plan, actuals and outcomes of business strategy, model and value chain; and (ii) To clarify the future potential, challenges, and opportunities.

Free space below for question list
[01]
[02]
[03]
[04]
[05]
[06]
[07]
[08]
[09]
[10]

Appendix 8B – Sample - Checklist for Effective Consultation Session

<u>CHECKLIST FOR EFFECTIVE CONSULTATION SESSION - ENSURING COMPREHENSIVE COVERAGE AND RISK ASSESSMENT</u>

Part (1) Outlining bank products and associated risk (consultation approach: process)
Part (2) Prescribing financial solution, reveal associated risk (consultation approach: doctor-patient)
Part (3) Elucidating credit facility structure and associated risk (consultation approach: expert)
Part (4) Exploring collateral valuation, associated relevant loan risk (consultation approach: emergent)
Part (5) Outlining pricing, affordability and associated risk (consultation approach: process)

Part (1) Outlining Bank Products and Associated Risk
(Consultation Approach: Process)

1.[ ] Large scale and consortium-based lending (e.g., syndicated loan)

2.[ ] Project and specialized financing (e.g., project financing, E&P financing)

3.[ ] Asset-specific lending (e.g., lease-based financing, asset-based financing)

4.[ ] Trade and working capital based lending

5.[ ] General corporate lending (e.g., Corporate financing)

6.[ ] Overview of bank product unique features affecting suitability of borrowers

Risk Management Checkpoints

[ ] Confirm understanding of risk implication in large scale and consortium-based lending
[ ] Assess comprehension of risk factors in project and specialized financing

Part (2) Prescribing Financial Solution, Reveal Associated Risk
(Consultation Approach: Doctor-Patient)

1.[ ] Bank's credit strategy (for in-house approver only)

2.[ ] Credit worthiness of sponsors (e.g. credit history)

3.[ ] Risk factors of the application affecting tailoring of terms and conditions (e.g. business strategy, earnings, repayment history, business outlooks, projected performance)

4.[ ] Assessing aligned needs of assets and debt-equity structure adequacy

5.[ ] Identifying financing means for structuring deals

6.[ ] Balancing client's asset-liability portfolio

Risk Management Checkpoints

[ ] Evaluate client's understanding of risk assessment in its debt-equity strategy
[ ] Verify comprehension of risks related to creditworthiness and repayment history

Part (3) Elucidating Credit Facility Structure and Associated Risk
(Consultation Approach: Expert)

1.[ ] Tailor-made financial package options

2.[ ] Terms and conditions for agreement (e.g., loan types, amounts, maturity, interest/fee, repayment structure, security/collaterals, covenants, defaults/remedies, jurisdiction)

3.[ ] Proposals on tailored solutions (for in-house approver only)

4.[ ] Specialized credit facility structure for various scales, sectors, and industries

5.[ ] Time horizon considerations (e.g., short term, mid to long term loans)

Risk Management Checkpoints

[ ] Confirm understanding of risks associated with specific terms and conditions of credit facilities
[ ] Assess comprehension of risks in tailored financial package options

Part (4) Exploring Collateral Valuation and Associated Relevant Loan Risk
(Consultation Approach: Emergent)

1.[ ] Understanding policy and best practices for collateral

2.[ ] Asset valuation

3.[ ] Factors affecting determination of accurate market values of assets/collaterals

4.[ ] Management information and analytics

5.[ ] Initiating, executing and reviewing value (inherent risk, fair market value)

6.[ ] Adjustment of risk associated with loan and evaluate adjustment necessity

7.[ ] Remedy and mitigation (recission, waterfalls, set off, top up collaterals)

Risk Management Checkpoints

[ ] Verify client's understanding of collateral risk management, including loan-to-value ratios and revaluation
[ ] Assess comprehension of inherent risks in asset valuation and risk adjustments necessary for loans

Part (5) Outlining Pricing and Affordability and Associated Risk (Consultation Approach: Process)

1.[ ] Regulatory impact on calculation of funding cost 2.[ ] Different approaches of pricing (e.g., all-in, credit-rating, product/service type) 3.[ ] Comparative pricing strategies 4.[ ] Calculate and evaluate revenue formula (e.g., funding, overhead/administration) 5.[ ] Determining, evaluating, selecting and recommending competitive offers 6.[ ] Evaluate, justify risk and profitability of a deal Risk Management Checkpoints [ ] Confirm understanding of risk implications in different pricing approaches [ ] Evaluate client's grasp on risk and profitability considerations in deal evaluation

Appendix 9 – Sample - Checklist for Presentation Session

CHECKLIST TO SUPPORT EACH STAGE OF THE PRESENTATION SESSION.

Part (1) Managing expectation
Part (2) Handling inquiry
Part (3) Observing buying signal
Part (4) Gaining commitment
Part (5) Closing the deal

Part (1) Managing expectation

Flow	Skills
1.[ ] Set clear objectives and boundary 2.[ ] Educate the client 3.[ ] Frequent update about client understanding 4.[ ] Have feedback loop to invite queries	[ ] Have structured content delivery [ ] Illustrate with document and tools [ ] Apply effective language use [ ] Have nonverbal communication [ ] Have balanced communication [ ] Being responsive [ ] Being interactive [ ] Build rapport

Part (2) Handling inquiry

Flow	Skills
1.[ ] Address concerns proactively 2.[ ] Give transparent communication 3.[ ] Give comprehensive information 4.[ ] Manage uncertainties	[ ] Being responsive [ ] Being interactive [ ] Shows flexibility and have contingent planning

Part (3) Observing buying signal

Flow	Skills
1.[ ] Recognize interest indicator 2.[ ] Identify concern resolution	[ ] Have nonverbal communication [ ] Being Responsive

Part (4) Gaining commitment

Flow	Skills
1.[ ] Clarify potential decision criteria 2.[ ] Summarize benefits 3.[ ] State clear next steps	[ ] Being customer centric

Part (5) Closing the deal

Flow	Skills
1.[ ] Confirm agreement 1.[ ] Confirm terms and conditions 1.[ ] Confirm needs documents	[ ] Illustrate with documents and tools

Appendix 10A – Sample - Checklist for Pre-negotiation Preparation

Pre-negotiation preparation - template

Step 1 – Complete the "TEMPLATE – PRE-NEGOTATION STRATEGY PREPARATION" for formulation of negotiation tactics. Your responses will be scored. The following table shows the structure of the template on the following pages.

Part	Section	Task	Questions	Topic
I	Aligning balanced offer to negotiation key drivers			
	A	Strategic alignment on key success drivers of negotiation		
		1	Capture insight on negotiation tactics	
			1	Long term interest – strategic purpose
			2	Short term interest – business need
			3	Bottom line – the least to accept
			4	Best alternative to a negotiated agreement
			5	Solutions – Bank's options of offers and client's potential counteroffers
			6	Solutions – Bank's concession causing deviations
	B	Strategic alignment on leverage components of negotiation		
		2	Recommend/structure the bank's balanced offer	
			7	Legitimacy
			8	Commitment
			9	Relationship
			10	Communication
II	Adapting balanced offer to situations			
	A	Negotiation paradigm		
		3	Analyze negotiation paradigm and potential clash	
			A1	Anticipated paradigm
			A2	Anticipated behavioural clashes
			A3	Anticipated ethical boundary
	B	4	Evaluate negotiation strength	
			B1	Information strength
			B2	Place strength
			B3	Power factor
	C	5	Anticipate concerns and evaluate their impact on the bank's balanced offer	
			C1	Maximum gain estimated
			C2	Anticipated concerns
			C3	Anticipated objections
	D	6	Anticipate the client's counteroffer and evaluate bank's adaptation	
			D1	Compliance
			D2	Risk tolerance
			D3	Application risk
			D4	Portfolio risk exposure
			D5	Revenue
			D6	Cost
			D7	Trust/Others
			D8	Relationship/Others
	E	7	Develop and execute exit strategy	
			E1	Triggering event
			E2	Timing of exit
			E3	Likelihood to execute exit plan
III	Negotiation tactics			
		8	Formulate overall negotiation tactics based on insights generated from task 1 to 7 in previous sections	

There are several responses formats:

1-filling in the blank
2-answering the question
3-circling the answer
4-writing text

TEMPLATE – PRE-NEGOTATION STRATEGY PREPARATION

Part (I) ALIGNING BALANCED OFFER TO NEGOTIATION'S KEY DRIVERS

TASK 1 - DEVELOPING A BALANCED OFFER (Complete 1 - 10)

(A) Strategic alignment on key success drivers of negotiation

Interest[124]: In interest-based negotiations, the intent is to reach a mutually agreed acceptable outcomes, sometimes that is mutually beneficial to both parties.

Business needs: Revealing from financial analysis, financial strength and credit strength analysis regarding the immediate business needs mutually beneficial to both parties.

Bottom line: The lowest acceptable point or the final offer a party is willing to accept in a negotiation.

BATNA: Best alternative to a negotiated agreement, defined as the most advantageous alternative that a bank can take if negotiation fail, and an agreement cannot be made

Option: Available choices parties might consider satisfying their interests, including conditions, contingencies and trades.

Concession: Adjusting on certain demands or positions to facilitate reaching an agreement

How to fill in the template?

Note 1:Q = Facilitating Question.

Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)

Note 3: Fill in the interim summary

	Key Drivers	Bank's Perspective	Client's Perspective
1	Long term interest – strategic purpose	Q-Refer to the Bank's credit strategy, what are our goals for the future? How do this align with this negotiation?	Q-Refer to the client's business strategy, what are the client's long-term business objectives? How can we align with them?
	• Must have	***I1a-Fill in the blank below:***	***I1d-Fill in the blank below:***
	• Should have	***I1b-Fill in the blank below:***	***I1e-Fill in the blank below:***
	• Nice to have	***I1c-Fill in the blank below:***	***I1f-Fill in the blank below:***
	I1g-Bank-client gap – insight from above analysis		
2	Short term interest – business need	Q-Refer to the Bank's business strategy, what immediate business needs must this negotiation address?	Q-Refer to the outcomes of the financial analysis on the client, what are the client's current financial priorities?
	• Must have	***I2a-Fill in the blank below:***	***I2d-Fill in the blank below:***
	• Should have	***I2b-Fill in the blank below:***	***I2e-Fill in the blank below:***
	• Nice to have	***I2c-Fill in the blank below:***	***I2f-Fill in the blank below:***
	I2g-Bank-client gap – insight from above analysis		
3	Bottom line – the least to accept	Q-Refer to inhouse analytics from similar cases for worst case, base case and best case, what is our minimum acceptable outcome from this negotiation?	Q-Refer to inhouse analytics on the same client for worst case, base case and best case, what might be the client's minimum expectations?
	• Financial	***I3a-Fill in the blank below:***	***I3c-Fill in the blank below:***
	• Non-financial	***I3b-Fill in the blank below:***	***I3d-Fill in the blank below:***
	I3e-Bank-client gap – insight from above analysis		
4	BATNA – (Best Alternative to a Negotiated Agreement)	Q-Refer to inhouse analytics of similar cases for BATNA in worst, base, and best BATNA, what is our best alternative?	Q-Refer to inhouse analytics on the same client's cases for BATNA in worst, base, and best BATNA, what is client's best alternative?
	Tangible	***I4a-Fill in the blank below:***	**I4c-Fill in the blank below:**
	Intangible	***I4b-Fill in the blank below:***	**I4d-Fill in the blank below:**

[124] Interest-based negotiation, Neil Katz & Kevin McNulty, 1995, Interest-Based Negotiation (syr.edu)

5	Solutions-Bank's options of offers and client's possible counteroffers	Q-What's our base offer? Refer to inhouse analytics on the same client's cases	Q-What's the counteroffer? Refer to inhouse analytics on the same client's cases
	• Option 1	***I5a-Fill in the blank below:***	***I5f-Fill in the blank below:***
	• Option 2	***I5b-Fill in the blank below:***	***I5g-Fill in the blank below:***
	• Option 3	***I5c-Fill in the blank below:***	***I5h-Fill in the blank below:***
	• Option 4	***I5d-Fill in the blank below:***	***I5i-Fill in the blank below:***
	• Option 5	***I5e-Fill in the blank below:***	***I5j-Fill in the blank below:***
6	Solutions – Bank's concessions causing deviations	Q-What's our potential concession?	Q-What's the client's expected concession?
	• Option 1	***I6a-Fill in the blank below:***	***I6d-Fill in the blank below:***
	• Option 2	***I6b-Fill in the blank below:***	***I6e-Fill in the blank below:***
	• Option 3	***I6c-Fill in the blank below:***	***I6f-Fill in the blank below:***

(B) STRATEGIC ALIGNMENT ON LEVERAGE COMPONENTS OF NEGOTIATION

Legitimacy: establish the fairness, process and outcomes and justifiability of the negotiation process and outcomes
Commitment: establish dedication to the negotiation process and adherence to any agreed terms
Relationship: establish the interpersonal and professional dynamics to maintain or enhance the relationship
Communication: establish effective exchange of information, proposals, and feedback throughout the negotiation

How to fill in the template?

Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)

	Key Drivers	Bank's Perspective	Client's Perspective
7	Legitimacy		
	• Strong	***I7a-Fill in the blank below:***	***I7c-Fill in the blank below:***
	• Weak	***I7b-Fill in the blank below:***	***I7d-Fill in the blank below:***
8	Commitment		
	• Strong	***I8a-Fill in the blank below:***	***I8c-Fill in the blank below:***
	• Weak	***I8b-Fill in the blank below:***	***I8d-Fill in the blank below:***
9	Relationship		
	• Strong	***I9a-Fill in the blank below:***	***I9c-Fill in the blank below:***
	• Weak	***I9b-Fill in the blank below:***	***I9d-Fill in the blank below:***
10	Communication		
	• Strong	***I10a-Fill in the blank below:***	***I10c-Fill in the blank below:***
	• Weak	***I10b-Fill in the blank below:***	***I10d-Fill in the blank below:***

I-Interim summary ***(Use template softcopy for extra space)***

Task (1) Capture insight on negotiation tactics - from analysis of the 10 key success drivers
Task (2) Recommend/structure the Bank's balanced offer.

. . .

Part (IIA) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 2 – EVALUATING NEGOTIATION PARADIGM

A-NEGOTIATION PARADIGM

How to fill in the template?

Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the interim summary

IIA-Fill in the information.

Counterpart	Name	Dept	Title	Decision Authority
Bank				
Client				

…

	Attributes	Distributive Paradigm i.e. win-loss	Integrative Paradigm i.e. win-win
A1	Anticipated Paradigm	Position-based[125] Distributive i.e. win-loss	Interest-based Integrative i.e. win-win
		IIA1a-Circle the party(s) likely to demonstrate the above paradigm: ***1-Bank 2-Client***	***IIA1b-Circle the party(s) likely to demonstrate the above paradigm:*** ***1-Bank 2-Client***
A2	Anticipated behavioural clashes	Factors leading to higher propensity for position-based/distributive paradigm: Personality: competitive Gender: assertive Culture: distinctive norm	Factors leading to higher propensity for interest-based/integrative paradigm: Personality: withdrawing Gender: collaborative Culture: diversified
		IIA2a-Circle the party(s) likely to demonstrate above behaviours: ***1-Bank 2-Client***	***IIA2b-Circle the party(s) likely to demonstrate the above behaviours:*** ***1-Bank 2-Client***
A3	Anticipated ethical boundary	Unethical negotiation -Manipulative -Coercive -Do not anticipate	Unethical negotiation -Excessive concession -Do not anticipate
		IIA3a-Circle the party(s) likely to demonstrate above behaviours: ***1-Bank 2-Client***	***IIA3b-Circle the party(s) likely to demonstrate above behaviours:*** ***1-Bank 2-Client***

IIA-Interim summary ***(Use template softcopy for extra space)***

Task (3) Analyze negotiation paradigm and potential clash.

[125] Interest-Based Negotiation (syr.edu)

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Part (IIB) ADAPTING BALANCED OFFER TO SITUATIONS

TEP 3 – EVALUATING NEGOTIATION POSITIONS

B – POSITION STRENGTH

How to fill in the template?

Note 1:Q = Facilitating Question

Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)

Note 3: Fill in the interim summary

B1 Information strength

Strong: Having comprehensive data on the client's financial history, market trends, and regulatory changes.
Medium: Possessing general knowledge about the client's industry and basic financial information
Weak: limited understanding of the client's specific business model or market condition

Strength (choose 1)	**Distributive i.e. win-loss** Time Tactics | Reveal information	**Integrative i.e. win-win** Communication Tactics | Reveal information | Promises | Concession
Strong	Time-set the agenda Revealing information	Revealing information Communication-Active listening (~20% time)
Medium	Time-control schedule	Concession Promises
Weak	Time – delay	Communication -Active listening (~20% time)
	IIB1a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	*IIB1b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:* *1-Bank 2-Client*

B2 Place strength

Strong: Negotiating from a position where the bank is primary financier or has substantial leverage over the client
Medium: A balanced relationship where both parties have comparable bargaining power
Weak: The client has multiple financing options besides your bank, reducing your leverage

Strength (choose 1)	**Distributive i.e. win-loss** Time Tactics | Authority	**Integrative i.e. win-win** Communication Tactics | Reveal information Concession
Strong	Time-threat ultimatum	Revealing information
Medium	Time-set final date	Concession
Weak	Authority-limited authority	Communication-Active listening (~20% time)
	IIB2a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: **1-Bank 2-Client**	**IIB2b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:** **1-Bank 2-Client**

B3 Power factor

Strong: Holding a significant advantage like exclusive rights to a necessary resource or a dominant market position
Medium: Having a good reputation in the industry, or unique expertise that is valuable but not exclusive
Weak: Limited influence over the negotiation outcome, perhaps due to a lack of unique offerings or lower market standing

Strength (choose 1)	**Distributive i.e. win-loss** HardTactics | Authority	**Integrative i.e. win-win** Communication Tactics | Reveal information Concession | Promises
Strong	Hard tactics – attack Hard tactics – cut off ties	Promises
Medium	Authority – unauthorized negotiation	Communication-Active listening (~20% time)
Weak	Authority – limited authority	Concession
	IIB3a-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well: *1-Bank 2-Client*	*IIB3b-Circles the party(s) likely to adopt the above tactics. Circle the strength and tactics as well:* **1-Bank 2-Client**

IIB-Interim summary ***(Use template softcopy for extra space)***

Task (4) Evaluate negotiation strength.

……

Part (IIC) ADAPTING BALANCED OFFER TO SITUATIONS

C-CONCERNS & OBJECTIONS

How to fill in the template?

Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Add your response below each appropriate question chosen
Note 4: Fill in the interim summary

STEP 4 - ANTICIPATING CONCERNS AND OBJECTIONS

Counterparts		Bank's Perspective Concrete Substance	Client's Perspective Concrete Substance	Bank & Client Relationship
C1	Maximum Gain estimated	**Choose the approach per analysis in A:**	**Choose the approach per analysis in A:**	**Choose the approach per analysis in A:**
		***IIC1a-Win-lose approach*:** Q-What is the bank's maximum gain in this negotiation?	***IIC1c-Win-lose approach:*** Q-What might be the client's utmost desired outcome?	***IIC1e-Trust & mutual agreement approach:*** Q-What common ground can both parties find to foster a mutually beneficial relationship?
		IIC1b-Trust & mutual agreement approach: Q-How can the bank balance its interests with maintaining a long-term client relationship?	***IIC1d-Trust & mutual agreement approach:*** Q-How can the client's need be met while fostering a trusting relationship with the bank?	
C2	Anticipated concerns	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**
		IIC2a-Win-lose approach: Q-What potential challenges or objections might the bank face, and how to turn this into opportunities.	***IIC2c-Win-lose approach:*** Q-What key concerns or hesitations might the client have regarding the bank's terms?	***IC2e-Trust & mutual agreement approach:*** *Q-What shred concerns might both parties have and how can these be collaboratively addressed?*
		IIC2b-Trust & mutual agreement approach: Q-What concerns might arise that could affect the long-term client relationship?	***IIC2d-Trust & mutual agreement approach:*** Q-How can the client's concerns be addressed to build trust in the negotiation process?	
C3	Anticipated objections	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**	**Choose the approach and fill in the blanks.**
		IIC3a-Win-lose approach: Q-What specific objections might the bank anticipate from the client and how can these be strategically countered?	***IIC3c-Win-lose approach:*** Q-What objections is the client likely to raise, and what are their underlying interests?	***IIC3e-Trust & mutual agreement approach:*** Q-How can both parties anticipate and manage objections to protect and enhance their relationship?
		IIC3b-Trust & mutual agreement approach: Q-How can the bank address objections in a way that preserves or enhances the relationship with the client?	***IIC3d-Trust & mutual agreement approach:*** Q-In what ways can the client's objections be resolved to strengthen trust and cooperation?	

IIC-INTERIM SUMMARY ***(Use template softcopy for extra space)***

Task (5) Anticipate concerns and evaluate their impact on the Bank's balanced offer.

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Part (IID) ADAPTING BALANCED OFFER TO SITUATIONS

STEP 5 – ASSESSING CLIENT' S COUNTEROFFER

D-IMPACT OF CLIENT'S COUNTEROFFER

How to fill in the template?

Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the interim summary

	Bank's Perspective Distributive (win-loss)	Bank's Perspective Integrative (win-win)
D1	Compliance – code of ethics, inhouse code of conduct, sales compliance ***IID1a-Win loss approach – Fill in the blank below:***	Compliance – code of ethics, inhouse code of conduct, sales compliance ***IID1b-Trust & mutual agreement approach– Fill in the blank below:***
D2	Risk tolerance ***IID2a- Win loss approach – Fill in the blank below:***	Risk tolerance ***IID2b-Trust & mutual agreement approach– Fill in the blank below:***
D3	Application risk ***II31a- Win loss approach– Fill in the blank below:***	Application risk ***IID3b-Trust & mutual agreement approach - – Fill in the blank below:***
D4	Portfolio risk exposure ***IID4a- Win loss approach– Fill in the blank below:***	Portfolio risk exposure ***IID4b-Trust & mutual agreement approach – Fill in the blank below:***
D5	Revenue ***IID5a- Win loss approach– Fill in the blank below:***	Revenue ***IID5b-Trust & mutual agreement approach - Fill in the blank below:***
D6	Cost ***IID6a- Win loss approach– Fill in the blank below:***	Cost ***IID6b-Trust & mutual agreement approach – Fill in the blank below:***
D7	Others ***II71a- Win loss approach– Fill in the blank below:***	Trust ***IID7b-Trust & mutual agreement approach – Fill in the blank below:***
D8	Others ***IID8a- Win loss approach: – Fill in the blank below:***	Relationship ***IID8b-Trust & mutual agreement approach – Fill in the blank below:***

IID-INTERIM SUMMARY ***(Use template softcopy for extra space)***
Task (6) Anticipate the client's counteroffer and evaluate Bank's adaptation.

. . .

Part (IIE) ADAPTING BALANCED OFFER TO SITUATIONS

<table>
<tr><td rowspan="6">STEP 6 – EXIT STRATEGIY</td><td colspan="3">E-EXIT STRATEGY</td></tr>
<tr><td colspan="3">How to fill in the template?
Note 1:Q = Facilitating Question
Note 2: Choose the appropriate cells to put your response. All response fields are numbered (for example, I1a, II2b)
Note 3: Fill in the interim summary
Note 4: Fill in the overall summary</td></tr>
<tr><td>E1</td><td>Triggering event</td><td>IIE1a - Fill in the blank below:</td></tr>
<tr><td>E2</td><td>Timing of exit</td><td>IIE2b - Fill in the blank below:</td></tr>
<tr><td>E3</td><td>Likelihood to execute exit plan</td><td>IIE3c-Fill in the blank below</td></tr>
<tr><td colspan="3">IIE-INITERIM SUMMARY (Use template softcopy for extra space)
Task (7) Develop and execute exit strategy.</td></tr>
</table>

. . .

Part (III) Formulation of Negotiation Strategy

OVERALL SUMMARY - FORMULATION OF OVERALL NEGOTIATION TACTICS

Task (8) Formulate overall negotiation tactics based on insights generated from above Task 1 – 7.

Appendix 10B – Sample – Checklist of Negotiation Skills

Note to trainers
This checklist was applied in simulation case (2). However, trainers may apply the same checklist for other negotiation activities.

Part (1) Skills in different negotiation stages
Stage-1 Framing the negotiation
Stage-2 Offering value
Stage-3 Adapting to situations
Stage-4 Gaining commitment
Stage-5 Closing the deal

Part (1) Skills in different negotiation stages

Stage-1 Framing the negotiation	**Points obtained maximum points: 4**
[ ] Objective setting and boundary definition (1 point) ***-Clearly defines objectives for negotiation*** ***-Establishes boundaries and limits effectively*** [ ] Educating the customer (1 point) ***-Demonstrates knowledge of client's needs and aligns solutions accordingly*** ***-Provides clear, relevant, and informative insights*** [ ] Updating client understanding (1 point) ***-Regularly checks and updates client understanding*** ***-Adjusts approach based on client feedback*** [ ] Feedback loop and queries (1 point) ***-Encourages and effectively handles client queries*** ***-Uses feedback to refine negotiation strategy***	

Stage-2 Offering value	**Points obtained maximum points: 6**
[ ] Balanced Recommendation (3 point) ***-Offers solutions that balance client needs with bank policies*** [ ] Offering Multiple Equivalent Simultaneous Offers (MESO) (3 point) ***-Presents multiple viable options to the client*** ***-Demonstrates flexibility and creativity in solutions***	

Stage-3 Adapting to situations	**Points obtained maximum points: 4**
[ ] Active listening (0.5 point) ***-Shows understanding of client concerns through active listening*** [ ] Demonstrating empathy (0.5 point) ***-Connects with client's concerns and exhibits empathy*** [ ] Assessing counteroffer (2 point) ***-Effectively evaluates and responds to client's counteroffers***	

Stage-4 Gaining commitment	**Points obtained maximum points: 4**
[ ] Making promises and giving concessions (4 points) ***-Balances concessions with bank's interest*** ***-Make promises that are aligned with capabilities***	

Stage-5 Closing the deal	**Points obtained maximum points: 4**
[ ] Confirming agreement (0.5 point) ***-Ensures clarity and mutual understanding of the agreement*** [ ] Demonstrating terms and conditions (0.5 point) ***-Clarifies and agrees on specific terms and conditions*** [ ] Confirming needed documents (2.0 point) ***-Ensures all necessary documentation is understood and prepared***	

Part (3) Overall negotiation performance

1. Adherence to negotiation process	**Points obtained maximum points: 18**
[ ] Adherence to negotiation process (6 points) ***-Consistently follows the structured negotiation*** [ ] Communication and Transparency (6 points) ***-Maintain clear, transparent, and effective communication throughout*** [ ] Strategic alignment with bank policies (6 points) ***-Align negotiation strategies with bank's policies and risk management***	

Appendix 11 – Sample – Integrated Behavioural Checklist for Module 3 Submodule 2

Part (1) Assessment on Consultation
Part (2) Assessment on Presentation
Part (3) Assessment on Negotiation

Part (1) Assessment on Consultation

1.FACTORS AFFECTING CLIENT'S RESPONSE TO PITCHING

Performance level 5
[ ] Demonstrate a deep understanding of factors affecting a client's comprehension regarding features and risk levels of alternatives.
[ ] Effectively identifies and addresses factors influencing client responses to different alternatives

Performance level 4
Shows good awareness of factors affecting client comprehension and response but might miss nuanced details.

Performance level 3
Adequately understands the primary factors but may overlook secondary or subtler influences.

Performance level 2
Has limited understanding of the factors affecting client comprehension and responses.

Performance level 1
Struggles to identify or misinterprets the factors influencing client understanding and responses.

..

2.INTERVIEW & COMMUNICATION FOR CLIENT'S SITUATION

Performance level 5
[ ] Skilfully interview clients to ascertain their financial situation and risk-bearing ability
[ ] Tailors communication strategies to each client's unique context.

Performance level 4
Effectively interviews clients but may have minor lapses in tailoring communication.

Performance level 3
Adequately identifies primary financial and risk factors but might miss deeper insights.

Performance level 2
Demonstrates limited ability in interviewing clients and adapting communication.

Performance level 1
Struggles to gain meaningful insights from client interviews.

..

3.TAILORING CONSULTANCY SERVICES

Performance level 5
[ ] Profoundly understands varying client needs based on business models, product knowledge, etc.
[ ] Provides tailored advice on investment and settlement methods.
[ ] Skillfully evaluates client situations and suggests the most suitable alternatives

Performance level 4
Provides sound advice and understands most client needs but may miss out in some details.

Performance level 3
Offers general advice with some tailored recommendations; may not capture all nuances of a client's situation.

Performance level 2
Has limited depth in understanding client needs and offering customized advice.

Performance level 1
Offers generic advice without consideration of the client's unique situation.

..

Part (2) Assessment on Presentation

1.FACTORS AFFECTING CLIENT'S RESPONSE TO PITCHING

Performance level 5

[ ] Demonstrate a deep understanding of the factors to trigger positive responses
[ ] Skillfully incorporates them into the presentation

Performance level 4

Understand most of the factors to trigger positive responses and integrate them well into the presentation.

Performance level 3

Understands most of the factors and integrates them well into the presentation.

Performance level 2

Demonstrate limited understanding and application of these factors in the presentation.

Performance level 1

Does not consider or misinterprets the factors affecting client's responses.

..

2. COMMUNICATION & INTERVIEW SKILLS

Performance level 5

[ ] Skillfully presents information
[ ] Effectively influences the audience
[ ] Persuades using a variety of communication techniques adapted to different sales approach

Performance level 4

Generally communicates clearly and persuasively, with minor lapses.

Performance level 3

Communicate adequately but lacks consistent persuasion and clarity.

Performance level 2

Demonstrates limited ability to communicate and influence.

Performance level 1

Struggles to convey information or influence the client.

..

3. COMMUNICATING RISKS TO CLIENT

Performance level 5

[ ] Clearly communicates risks
[ ] Empathetically addresses concerns
[ ] Uses simple language and active listening
[ ] Provides balanced communication on risks and benefits
[ ] Uses questioning and seek clarification

[ ] Exhibits appropriate body language and builds trust and rapport

Performance level 4
Communicates most risks adequately but may miss out on some details.

Performance level 3
Manages to convey the basic risks but lacks depth in the communication.

Performance level 2
Inconsistently communicates risks or misses out on key points.

Performance level 1
Does not effectively communicate risks or misinforms clients.

..

4. MANAGING CLIENT EXPECTATION

Performance level 5
[ ] Set clear objectives and boundary
[ ] Provides transparent communication
[ ] Make realistic promises
[ ] Addresses concerns proactively
[ ] Offers effective post-deal support

Performance level 4
Manages expectations well in most areas but might miss or underperform in some.

Performance level 3
Manages basic expectations but may not handle more complex expectations.

Performance level 2
Demonstrates limited skills in managing expectations.

Performance level 1
Fails to manage or mismanages client expectations.

..

5. PREPARATION FOR PRESENTATION

Performance level 5
[ ] Exceptionally well-prepared for the presentation
[ ] Accurately forecasts inquiries and objections
[ ] Has answers readily prepared
[ ] Collaborates with technical experts when necessary

Performance level 4
Adequately prepared for most inquiries and objections, some areas might lack depth.

Performance level 3
Show basic preparation but might be caught off guard by certain inquiries or objections.

Performance level 2
Limited preparation evident; frequently needs assistance or fails to answer inquiries.

Performance level 1
Appears unprepared or gives incorrect or misleading information.

..

6. HANDLING CLIENT INQUIRIES ON TECHNICAL ISSUES

Performance level 5
[ ] Addresses all inquiries professionally
[ ] Showcases deep technical knowledge and competence

Performance level 4
Handles most inquiries adequately but might falter on complex issues.

Performance level 3
Manage basic inquiries but struggles with more technical ones.

Performance level 2
Frequently requires assistance or provides incorrect answers.

Performance level 1
Appears uninformed or misinforms clients on technical aspects.

..

7. DETECTING BUYING SIGNALS & CLOSING DEALS

Performance level 5
[ ] Expertly detects buying signals
[ ] Uses the most appropriate closing techniques for client satisfaction

Performance level 4
Detects most buying signals and generally uses effective closing techniques.

Performance level 3
Detects some buying signals but might miss opportunities or use suboptimal closing techniques.

Performance level 2
Struggles to detect buying signals or uses ineffective closing techniques.

Performance level 1
Does not detect buying signals or fails to close deals effectively.

..

Part (3) Assessment on Negotiation

1.NEGOTIATION KNOWLEDGE & THEORY

Performance level 5
[ ] Demonstrates profound understanding of various negotiation theories
[ ] Applies appropriate negotiation approaches e.g. structural, strategic, behavioural, processes, integrative).
[ ] Demonstrates aptitude in different negotiation styles e.g. competing, collaborating, compromising, accommodating, avoiding.
[ ] Adapts strategies based on varying situations and assesses counteroffers proficiently.

Performance level 4
Understands and applies most negotiation theories and strategies but may have minor inconsistencies.

Performance level 3
Adequately applies basic negotiation theories but lacks depth in strategy adaptation.

Performance level 2
Demonstrate limited ability in applying negotiation strategies and theories.

Performance level 1
Struggle with understanding or appropriately applying negotiation theories and strategies.

..

2.OPERATIONAL STEPS FOR COMPROMISE SOLUTIONS

Performance level 5
[ ] Proficiently identifies interests, people, and their negotiation styles.
[ ] Determines actual needs and bottom lines for both the client and the bank.
[ ] Evaluates positions and anticipates potential concerns and objectives.
[ ] Identifies viable alternatives and options, establishes criteria, gains commitment, and knows when to exit negotiations.

Performance level 4
Effectively navigates most operational steps but may overlook or inadequately address some

Performance level 3
Manages basic steps for compromise but may lack foresight in anticipating concerns or providing alternatives.

Performance level 2
Shows limited proficiency in navigating compromise steps, often missing key aspects.

Performance level 1
Struggles with or misapplies the operational steps for compromise.

..

3.NEGOTIATION TACTICS AND ADAPTATION

Performance level 5
[ ] Collaborates effectively with technical specialists for proposal structuring.
[ ] Skillfully plans negotiation strategies with compelling reasons.
[ ] Adapts seamlessly to varying negotiation styles and demonstrates proficient influencing and persuasive skills

Performance level 4
Adapts well to most negotiation styles and scenarios but might have minor lapses in strategy planning.

Performance level 3
Generally understands negotiation tactics but may lack depth in adaptation or planning.

Performance level 2
Limited in employing diverse negotiation tactics or adapting to different styles.

Performance level 1
Struggles to employ effective negotiation tactics or adapt to varying negotiation styles.

..

4.EXIT STRATEGY

Performance level 5
[ ] Demonstrates clear understanding of when and how to exit negotiations
[ ] Conduct exit professionally and tactically, ensuring future opportunities aren't compromised.

Performance level 4
Understand the importance of well-timed exit but may lack tact in execution.

Performance level 3
Recognizes basic exit strategies but may struggle with execution or timing.

Performance level 2
Often misjudges the timing or manner of exit from negotiations.

Performance level 1
Lack understanding or skill in implementing an effective exit strategy.