Contents

List	of Ta of Fig es on		utors	x Xi Xiii
Part I Regul		Regul	atory Framework	1
1	Introduction			3
	Mario Anolli and Elena Beccalli			3 3 3
	1.1	1 Why retail credit risk management?		
	1.2	2 The book		
		1.2.1	Part I: the regulatory framework	5
		1.2.2	Part II: risk taking: measurement, pricing,	
			and management	5
		1.2.3	Part III: portfolio credit risk: measurement	
			and management	7
		1.2.4	Part IV: operational implications	8
Par	t II	Risk T	Taking: Measurement, Pricing, and	
	Man	ageme	ent	11
2	The Ever-evolving Basel Accord			13
	Dan	amiano Guadalupi		
	2.1	Introd	luction	13
	2.2	The 19	988 Capital Accord	14
		2.2.1	Regulatory capital	14
		2.2.2	Risk-weighted assets	15
		2.2.3	Basel I limits	18
	2.3	The ne	ew Capital Accord (Basel II)	19
		2.3.1	General features	19
		2.3.2	Credit risk: the standardized approach	24
		2.3.3	Credit risk: the Internal Rating Based (IRB)	
			approach	29
	2.4	Towar	d Basel III and beyond	48
		2.4.1	Taking stock of the Basel II framework	48
		2.4.2	The Basel Committee's response to the	
			financial crisis	51

Priv	ate Ind	lividuals: Credit Risk Modeling	59
Corrado Giannasca and Tommaso Giordani			59
3.1	3.1 Introduction		
3.2	Retail	credit risk	59
		Judgmental versus statistical models	60
	3.2.2	Individual versus portfolio models	61
		The critical role of data	62
	3.2.4	Model monitoring	63
3.3	Indivi	dual model framework and management	63
	3.3.1		
		risk scorecard	68
	3.3.2	Impact of models on credit and underwriting	
		policies	70
3.4	Portfo	lio model framework	71
	3.4.1	Portfolio models: impairment forecasting	72
3.5	Concl	usions	75
SME	s: Cred	lit Risk Modeling	77
Ema	nuele G	iovannini	77
4.1	Introd	luction	77
4.2	Intern	al and external rating systems	78
4.3	Extern	nal or agency rating	79
4.4	Intern	al or bank rating	80
		Information for internal rating	82
	4.4.2	Customer records	82
	4.4.3	Qualitative information	82
	4.4.4	Financial information	83
4.5	Risk n	nanagement and rating	87
4.6	Capita	al allocation strategy is another way of using	
	intern	al rating models	90
The	Critica	l Model Parameter: LGD	91
Elisa	Alghisi	i Manganello and Valentina Leuca r i	91
	Introd	-	91
5.2	Overview of LGD		91
	5.2.1	Definition and calculation	92
	5.2.2	Basel II versus the IAS 39 framework	93
	5.2.3	Cure rate/danger rate	95
5.3		ods for LGD estimation	96
		Overview of the estimation process	96
	5.3.2	Conditional means model	99
	5.3.3	Regression models	101

		5.3.4	Chain-ladder model	103
		5.3.5	Cure-rate estimation	107
6	Model Validation			
	Antonio Arfé and Paolo Gianturco			109
	6.1	Introduction		
	6.2	Internal validation – organizational structures		
	6.3	The validation process		
	6.4	5.4 Internal validation activities		
			Models	112
		6.4.2	Process and governance	127
		6.4.3	IT and data quality	131
7	Risk-Adjusted Performance Measures			134
	Mar	Mario Anolli		
	7.1	Introd		134
	7.2	Basic r	isk-adjusted performance measures	135
		7.2.1	RAPM and capital allocation	136
	7.3			137
			Allocated versus utilized capital	138
			Diversified versus undiversified capital	141
	7.4		arities of RAPM for retail credit risk management	144
		7.4.1	Model inputs	145
Par	t III	Portfo	lio Credit Risk: Measurement and	
	Man	ageme	ent	149
8	Portfolio Credit Risk Modeling			151
	Lorenzo Bocchi and Tiziano Bellini			151
	8.1	Introd	uction	151
	8.2 Portfolio credit risk modeling		lio credit risk modeling	152
		8.2.1	Regulatory capital, risk-weighted assets, and	
			economic capital	154
	8.3	Defaul	t models	155
		8.3.1	Regulatory formula	157
		8.3.2	Economic capital measurement	160
	8.4	Case study: portfolio analysis		
9	Stress Testing, Capital Planning, and Risk Integration			
	Tiziano Bellini and Lorenzo Bocchi			168
	9.1	Introduction 10		
	9.2	Stress 1	•	169
		9.2.1	Stress testing in practice	170

		9.2.2	Stress testing and Prometeia economic	
		•	capital model	171
		9.2.3	Case study: stress testing	173
	9.3 Managerial portfolio analysis: from loan policies to			
			olanning	174
			Case study: loan policies and capital planning	176
	9.4	Risk int	, .	179
10	Port	folio Ma	nagement	183
	Tom	maso Gio	rdani and Corrado Giannasca	183
	10.1	Introdu	ction	183
	10.2	Team or	ganization and competence model	184
	10.3	Portfolio	o management cycle	185
	10.4	Existing	portfolio management	186
		10.4.1	Economic cycle	187
		10.4.2	Collection performance	189
		10.4.3	Models	190
		10.4.4	Managerial actions	190
	10.5	New bus	siness portfolio management	191
		10.5.1	Profitability and pricing	191
		10.5.2	Cut-off strategy	194
		10.5.3	Credit policy revision	195
		10.5.4	Lending strategy monitoring	196
Par	t IV	Operati	ional Implications	199
11	IT Systems for Credit Risk Management			201
	Renzo Traversini and Anselmo Marmonti			
	11.1	Introdu	ction	201
	11.2	Credit re	elated information – CDW (Credit Data	
		Wareho	use)	202
		11.2.1	Information quality management	203
			Master data management	203
	11.3	Models	for risk components – the development	
			ment of internal rating	203
			Model management and model deployment	
			components	204
			Credit portfolio valuation and	
			management system	204
			Analytical information on	
			credit risk – CR data mart	205
			Dashboard e-reporting	206

11.4 IT system to support credit risk management		
activities – key functional issues	206	
11.4.1 The general features of credit risk		
management systems	206	
11.5 IT technologies for credit risk management –		
key aspects	209	
11.5.1 Data management and data quality –		
warehousing technologies	210	
11.5.2 Modeling environment	210	
11.5.3 Integration – platform approach	211	
11.5.4 The scoring engine	212	
11.5.5 Portfolio risk engine	213	
11.6 Current status and trends for IT credit risk		
management systems	214	
12 A New Retail Credit Risk Management Approach to		
Cope with the Crisis	219	
Francesco Merlin 12.1 Introduction		
12.3 Risk management in retail credit process	222	
12.3.1 Origination and underwriting	223	
12.3.2 Strengthen an end-to-end risk mindset in		
retail credit process	224	
12.3.3 Credit monitoring and workout	226	
12.3.4 The benefits of systematic procedures in		
credit workouts	227	
12.3.5 Behavioral scoring	228	
12.3.6 Reducing exposures to high-risk customers	229	
12.3.7 Extracting value from debt recovery	230	
Index	233	