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CCP ADVANCED LEVEL

PILOT PAPER

ADVANCED CREDIT RISK MANAGEMENT

December 2021. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

(a) The main purpose of collateral is to improve the creditor's chances of getting its money back from the debtor. While taking collateral and considering it in securing credit facilities, it should be understood that collateral is not the primary repayment source.

In reference to the above statement:

(i) Discuss four principles to be borne in mind while granting credit on the basis of securities. (8 marks)

(ii) Summarise five precautions taken by lenders when using immovable property as collateral. (5 marks)

(b) With reference to prudential guidelines on lending as provided by the Central Bank from year 2013, interpret the following:

(i) Classification of multiple facilities. (3 marks)

(ii) Reclassification of non-performing loans and advances. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Discuss five benefits of credit portfolio management. (10 marks)

(b) One of the major cause of risk exposures in credit portfolios is "credit concentration". With regard to this observation:

(i) Interpret the term credit concentration. (2 marks)

(ii) Assess four ways by which credit concentration does occur. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) While pricing credit risk, several factors need to be considered with credit default risk being most crucial.

Required:

(i) Discuss four credit pricing methods. (8 marks)

(ii) Examine the four main components included in credit pricing models by lending institutions (8 marks)

(b) The advent of credit derivatives has been heralded as a path-breaking innovation that enables institution to mitigate credit risks with more flexibility. In line with this and management of credit portfolios, summarise the advantages of credit derivative instruments to:

(i) The protection buyer. (2 marks)

(ii) The protection seller. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Project financiers look primarily at the project cash inflows rather than the assets for repayments and therefore an understanding of the projects' financial risks is critical. Discuss five project financial risks that lenders of project finance should mitigate. (10 marks)

(b) Evaluate five ways by which credit managers could mitigate credit risks emanating from a borrower's working capital management. (10 marks)

(Total: 20 marks)

QUESTION FIVE

(a) With reference to firm risks, portfolio risks and capital adequacy:

(i) Summarise four benefits of credit loss distribution. (4 marks)

(ii) Using three bases, distinguish regulatory capital from economic capital. (6 marks)

(b) Propose five lessons that could be drawn from year 2008 global credit crisis. (10 marks)

(Total: 20 marks)

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