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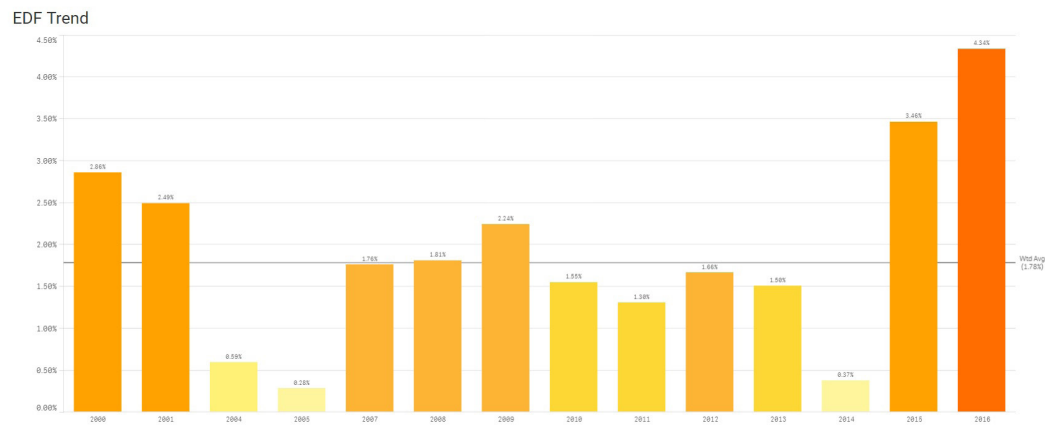
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The Power of Credit Risk Benchmarking: Incorporating Benchmark Data into Portfolio Management

Analyzing internal and publicly available financial data alongside supplemental data through a visualization tool enhances credit risk management practices for risk professionals. Access to industry data and dynamic dashboards of credit and market performance improves credit risk benchmarking, portfolio management, credit loss estimation, and credit risk modeling. This article will focus on three different approaches to credit risk benchmarking, which provides context for measuring portfolio performance and brings objectivity to the exercise.

Portfolio Benchmarking

Portfolio benchmarking of a financial institution's historical data provides trend analysis throughout time. For example, portfolio and risk managers can look at their own portfolio for year-over-year trends or before and after a major event, such as an acquisition. Benchmarking your portfolio can help you identify and monitor trends within particular industries, geographies, or product lines to spot opportunities for growth or pinpoint areas that can require remedial attention.

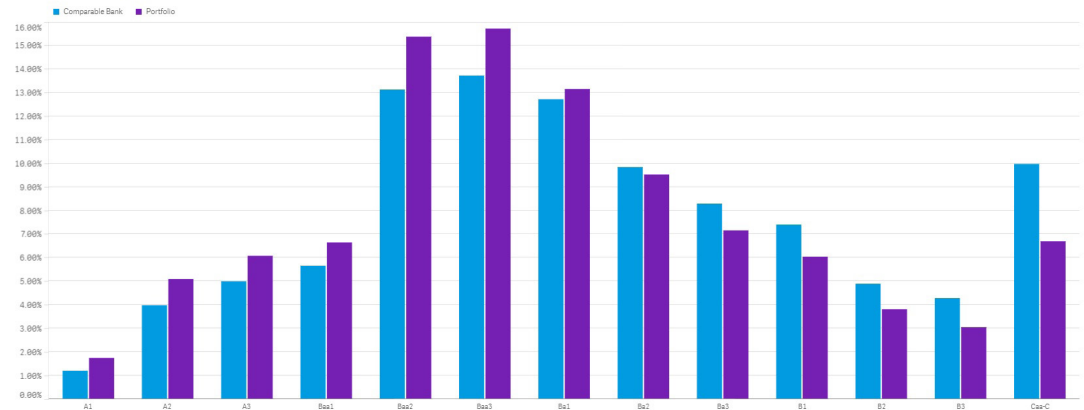


Portfolio Benchmarking: In this graph, a risk manager can observe this portfolio's risk trend through time and an increase in the portfolio's probability of default (PD), or EDF™ (Expected Default Frequency), in 2015 and 2016. The next step is to pinpoint the root cause by looking into financial ratio drivers causing the increase in risk. It is also worth looking into specific segments of the portfolio with higher risk exposure.

Peer Benchmarking

Peer benchmarking is a critical step to strategic planning for an institution. By comparing your portfolio to that of a peer institution, you gain a broader overview of where you stand on risk metrics, such as probability of default (PD), loss given default (LGD) or expected loss (EL). For the comparison to be meaningful, you should benchmark yourself against a comparable peer. For example, a financial institution that operates primarily in the agriculture business or in commercial real estate will want to compare itself to a similar bank (roughly the same size, geography, and concentration). When benchmarking internal ratings to an external source, it is best practice to map all ratings to a standard scale.

EDF Implied Rating Distribution

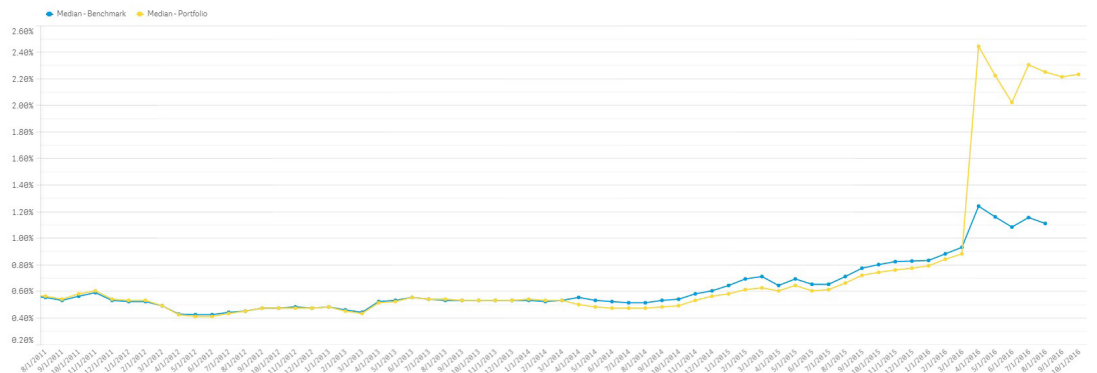


Peer Benchmarking: A portfolio is compared with peer portfolios in the Credit Research Database (CRD™), Moody's Analytics proprietary database of private firm financial statements and defaults. This graph shows whether a portfolio aligns with the wider industry experience. A deeper investigation is necessary if an anomaly arises from what is observed in the benchmark data.

Industry Benchmarking

Industry benchmarking compares a portfolio to a representative portfolio constructed from benchmark data based on borrower characteristics, such as industry, region, or size. This approach provides more in-depth knowledge on industry performance, risk sensitivities, and emerging trends to improve commercial credit analysis. Industry benchmark data can be obtained from different industry consortia. The advantage is that an external data vendor can aggregate, clean, and normalize data from multiple sources and institutions. This consistency ensures that credit risk metrics being benchmarked are comparable.

EDF Time Series



Industry Benchmarking: The graph above shows the EDF trends of an institution's Mining, Oil and Gas portfolio compared to industry data from Moody's Analytics Credit Research Database. It is prudent to identify early signals of industry distress by comparing a specific industry, with a broader data set. This timely insight allows risk managers to observe trends, reshape their lending strategy in certain industries or regions, and also reevaluate their investment strategies.

Summary

The credit environment is becoming more dynamic and interconnected across global markets and asset classes. It is important for risk professionals to assess and take advantage of next generation solutions for credit data insight and analytics. Moody's Analytics RiskBench™ platform is an innovative solution that allows risk practitioners to easily benchmark and analyze credit portfolios using visual and interactive dashboards. Built with data from the largest and cleanest database of financial statements and defaults, Moody's Analytics proprietary Credit Research Database (CRD™), the RiskBench platform provides valuable insight to make better credit risk decisions.

Learn more at www.moodyanalytics.com/riskbench.

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