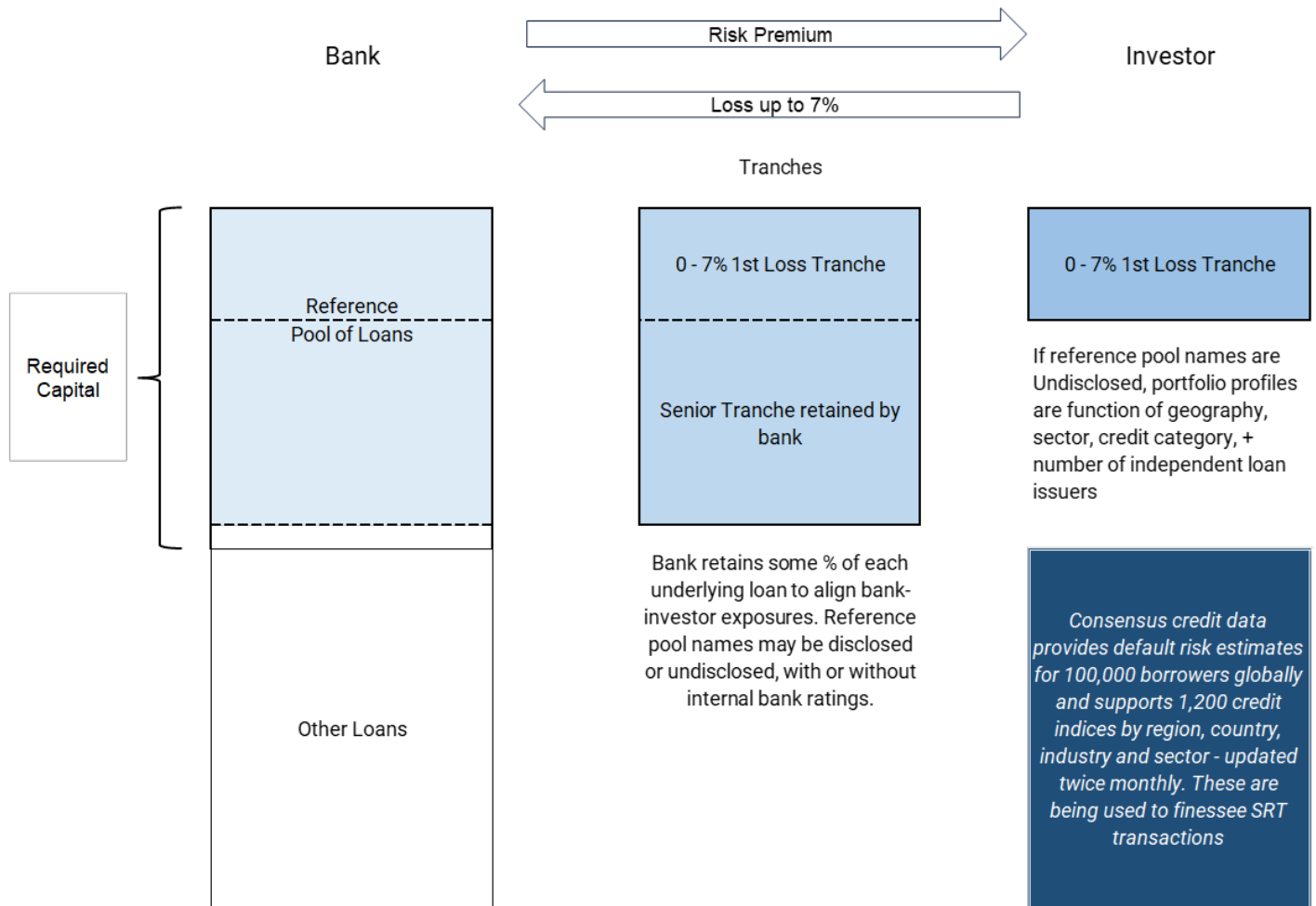# Consensus Default Risk Analytics for Capital Trade Optimisation

October 2023

Significant Risk Transfer volumes continue to grow, and are dominated by synthetic transactions where the bank retains ownership of the underlying assets.

Financial markets are most successful when there is transparency over risk and pricing, but full disclosure is not always possible for an SRT trade. This does not prevent deals, but it requires both sides of the transaction to balance risk and return across a range of dimensions. These include the geography, industry and credit category of the underlying borrowers, plus lower limits on the number of independent loans in the reference pool.

Consensus default risk data is useful for most types of transactions to finesse risk and optimise returns. The diagram below is just one of the most common structures.
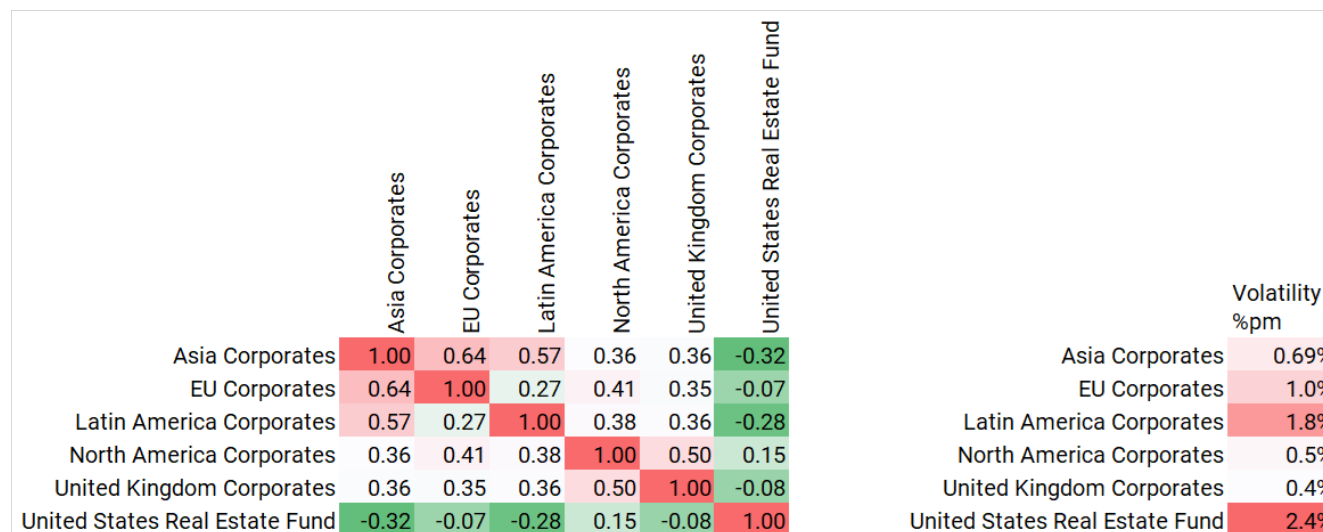

Bank — Risk Premium → **Investor**
← Loss up to 7%

Tranches

Required Capital

Reference Pool of Loans

Other Loans

0 - 7% 1st Loss Tranche

Senior Tranche retained by bank

Bank retains some % of each underlying loan to align bank-investor exposures. Reference pool names may be disclosed or undisclosed, with or without internal bank ratings.

0 - 7% 1st Loss Tranche

If reference pool names are Undisclosed, portfolio profiles are function of geography, sector, credit category, + number of independent loan issuers

Consensus credit data provides default risk estimates for 100,000 borrowers globally and supports 1,200 credit indices by region, country, industry and sector - updated twice monthly. These are being used to finessee SRT transactions

Example: Using Consensus Default Risk estimates to optimise SRT transactions for both sides.

Offered Asset Classes: North American, European and Asian Medium to Large Corporates (including some REITs), plus 10% in Latin American Corporates. Underlying borrowers undisclosed.

The table below shows recent correlations between these asset classes, based on monthly % changes in default risks.

Volatilities and Correlations Between Monthly Default Risk Changes, Past 18 Months

	Asia Corporates	EU Corporates	Latin America Corporates	North America Corporates	United Kingdom Corporates	United States Real Estate Fund
Asia Corporates	1.00	0.64	0.57	0.36	0.36	-0.32
EU Corporates	0.64	1.00	0.27	0.41	0.35	-0.07
Latin America Corporates	0.57	0.27	1.00	0.38	0.36	-0.28
North America Corporates	0.36	0.41	0.38	1.00	0.50	0.15
United Kingdom Corporates	0.36	0.35	0.36	0.50	1.00	-0.08
United States Real Estate Fund	-0.32	-0.07	-0.28	0.15	-0.08	1.00

	Volatility %pm
Asia Corporates	0.69%
EU Corporates	1.0%
Latin America Corporates	1.8%
North America Corporates	0.5%
United Kingdom Corporates	0.4%
United States Real Estate Fund	2.4%

Based on these estimates, the investor concludes that while the US Real Estate Funds appear to offer strong diversification (most of the correlations are negative) they have also been very volatile (2.4% per month, even higher than Latin American default risk volatility). If the investor also has a negative outlook for Real Estate Fund credit over the duration of the trade, they may reject this exposure or they may negotiate for specific LTV criteria and sub-sector exposures.

Since credit consensus data supports more than 1,200 indices, this type of transaction can be further analysed; for example the North American portfolio can be analysed by country and industry / sector and the historic analysis period can be altered to suit the transaction duration and the expected credit environment.

Even if borrower names are undisclosed, the large credit consensus coverage of more than 100,000 single names gives the investor an indication of the credit distribution across the sector as well as the range of default risk estimates making up each consensus estimate.

For example, the chart below shows the credit distribution for US Telecoms:

Credit Level: US Telecoms
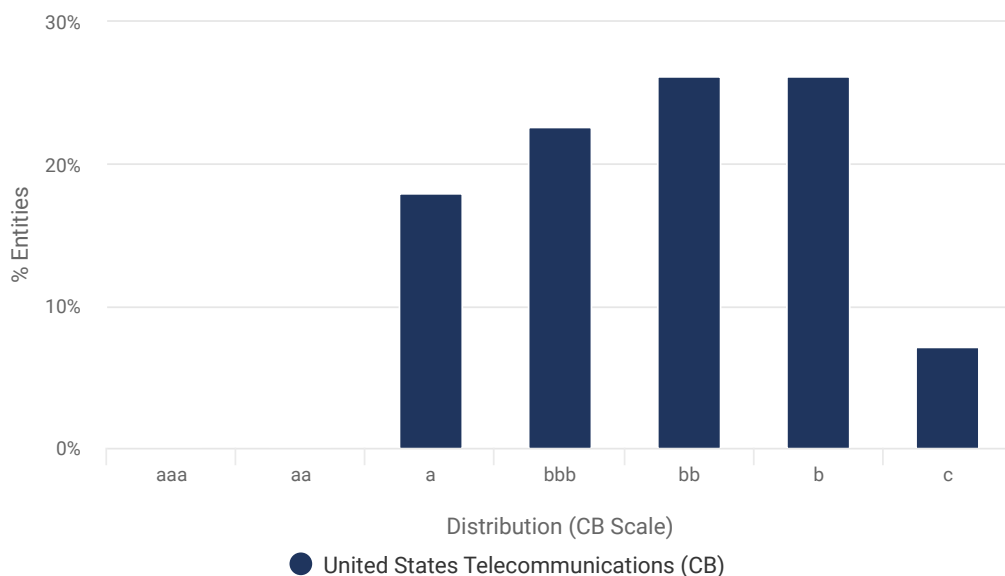
While some borrowers in the US Telecom sector are still in the **a** category, the majority are non-Investment Grade and the single largest group is the **b** category; while more than 5% are in the **c** category. This chart alone might prompt an investor to seek further finessing in the trade.

In disclosed portfolio transactions, Credit Consensus Ratings ("CCRs") for single borrowers provide investors with an unbiased view of the inbound portfolio and allows for monitoring of the collected portfolio. In particular, investors can compare the credit distribution (see below) of current and proposed portfolios, in their own credit scales as well as the classic 21-category format for comparison with external quotes. The chart below shows a detailed comparison based on individual CCRs. (Red dotted lines show differences of more than one notch).

### Client vs CB Rating Comparison
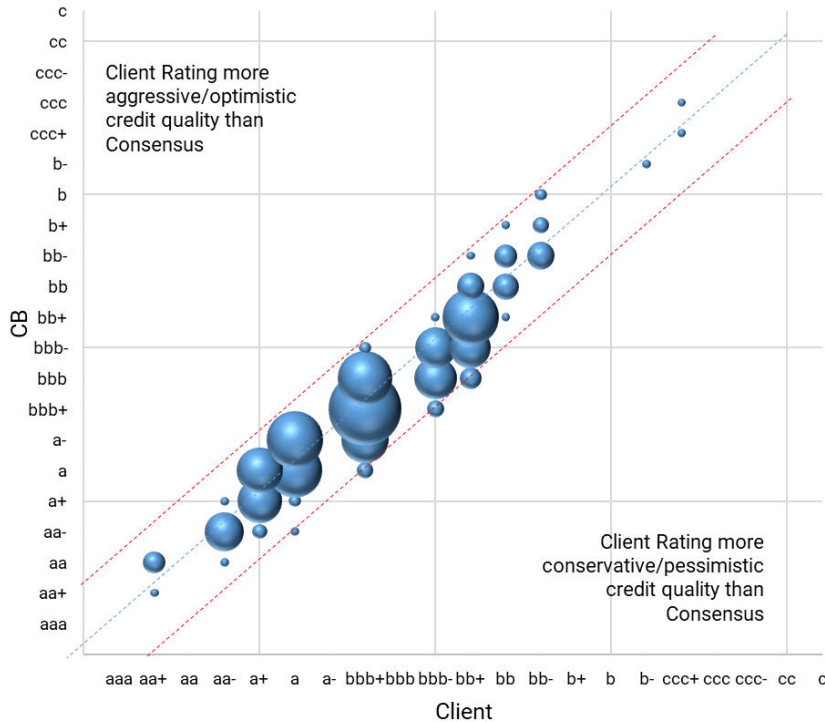
Banks can leverage similar analysis based on detailed CCRs, but without the need to divulge individual entity ratings. Comparative credit distribution analysis allow them to demonstrate the efficacy of their underwriting standards.

For undisclosed transactions, banks can demonstrate how internal pool ratings compare with the market, again without divulging either entity specific detail or ratings linked to specific entities, providing a clear and tangible quantification of the efficacy of bank underwriting standards.

Like-for-Like Comparison: Whole Portfolio
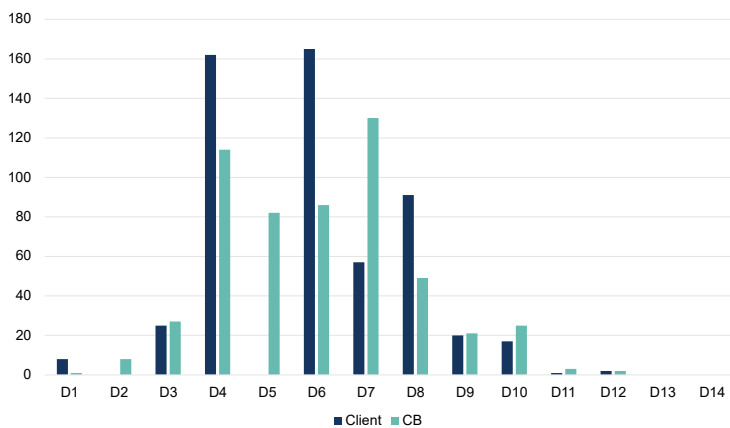
Notch Differences: High Yield Portion
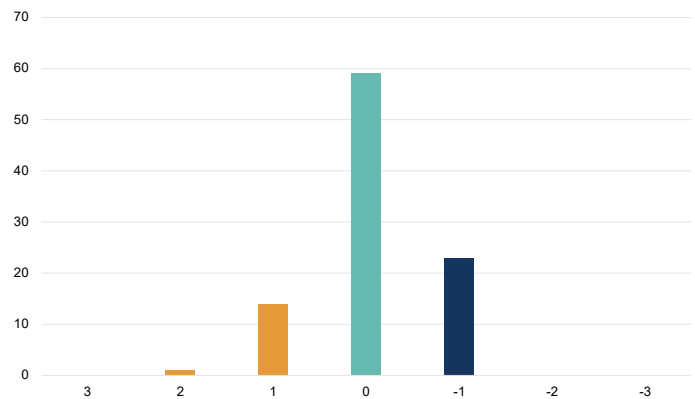
The rich consensus dataset also supports ongoing portfolio monitoring, servicing and substitutions. Detailed CCRs allow investors to assess marginal changes to risk through additional transactions.

For banks who provide ongoing portfolio / trade reporting, consensus data is an independent and regularly updated reference point covering the portfolio lifecycle from trade inception onwards.

Credit Benchmark can produce bespoke and confidential portfolio credit reports on request. For a free portfolio credit report and to learn how consensus default risk data is now being used every day in SRT transactions, please get in touch here.

Sample Portfolio Credit Report: United States High Yield Corporates

Credit Benchmark® — Portfolio Credit Report — Oct-23

Portfolio Details - US HY Corporates

Current CCR Coverage	Public	CRA Rated
1369	23%	46%

Entities With Best Credit Quality

1. GYP HOLDINGS III CORP
2. JBS USA FOOD CO
3. KB HOME
4. OPEN TEXT HOLDINGS INC
5. OLIN CORP

Entities With Worst Credit Quality

1. NORVAX LLC
2. X CORP, US
3. TELESAT LLC
4. AMC ENTERTAINMENT HOLDINGS INC
5. STONERIDGE INC

Entities Showing Improvement

1. UBER TECHNOLOGIES INC
2. MILLERS ALE HOUSE INC
3. PBF HOLDING CO LLC
4. CHOBANI INC
5. SAMSONITE LLC

Entities Showing Deterioration

1. HAWAIIAN ELECTRIC INDUSTRIES INC
2. FUNKO LLC
3. NUTRITION & BIOSCIENCES INC
4. SCOTTS MIRACLE GRO CO
5. BGSF INC

6M Transition Matrix

6-Months Ago	Current IG	Current HY
IG	0%	100%
HY	0%	100%

Region

North America

Industry

Consumer Goods, Other, Technology, Oil & Gas, Consumer Services, Industrials

Country

United States

Sector

General Retailers, Oil & Gas Producers, Software & Computer Services, Support Services, Other

CCR Distribution

% of Entities vs CB Scale (Average PD Bps): aaa/aa, a, bbb, bb (100.2) 65%, b/c (1248.8) 35%

Upgrades / Downgrades / Trend

Upgrades, Downgrades, Credit Trend — % of Entities / Change in Credit Risk (Improving / Deteriorating), Aug-21 through Aug-23

Contact

To find out how we can help, please contact us:

Email: info@creditbenchmark.com

UK Office (London): +44 (0)20 7099 4322

US Office (New York): +1 646 661 3383

Or visit www.creditbenchmark.com

About Credit Benchmark

Credit Benchmark provides Credit Consensus Ratings and Analytics based on contributed risk views from 40+ of the world's leading financial institutions, almost half of which are GSIBs, domiciled in the US, Continental Europe, Switzerland, UK, Japan, Canada, Australia and South Africa.

The risk views are collected, aggregated, and anonymized to provide an independent, real-world perspective of credit risk, delivered twice monthly to our partners. Credit Consensus Ratings and Analytics are available on 100,000+ corporate, financial, fund and sovereign entities globally, 90% of which are unrated by credit rating agencies.

Credit Benchmark also produces over 1,200 credit indices, which help risk practitioners better understand industry and sector macro trends.

Risk professionals at banks, insurance companies, asset managers and other firms use the data to gain visibility on entities without a public rating, inform risk sharing transactions (CRT / SRT), monitor and be alerted to changes within the portfolio, benchmark, assess and analyze trends, and fulfil regulatory requirements and capital.

Visit https://www.creditbenchmark.com to learn more.

Disclaimer