# Taming Risk: Complete Credit Portfolio Management

## Summary

The book is divided into three parts. The first addresses the background, size and growth of the credit markets; the nature of credit risk; the historical pattern of credit returns; the approach of the rating agencies; and the motivation for credit portfolio management. I feel it is important to deal with these matters first so that readers have an understanding of the basics before discussing issues of greater complexity in later chapters. Chapter 2 concentrates on the key drivers that underpin the increasing interest in credit portfolio management amongst financial institutions. In summary, Part I attempts to explain why and how the credit market has reached its current size; examines the scope and complexity of the various credit sectors; and explains why it is likely to grow rapidly in the foreseeable future. Part II then addresses the tools available for portfolio management, including loan trading, credit derivatives, cash and synthetic securitisation and an assessment of the options available to handle impaired debt. It concludes with two technical chapters describing the theoretical and conceptual framework for pricing default, including the valuation of credit derivatives and the modelling of credit instruments in a portfolio context. At the end of Part II readers should have a thorough understanding of the credit markets and instruments. Part III discusses practical issues facing different types of investors: banks; institutional credit fund managers; insurance companies; and the opportunities (and risks) facing private clients looking to add credit to their portfolios. Chapter 7 is devoted to the bank perspective. Banks are the largest holders of credit risk and the way in which they manage their credit portfolios is changing rapidly. I discuss how banks can achieve greater efficiency by centralising management of their loan portfolio and managing it on similar lines to an institutional fund manager. This approach often requires radical organisational changes and may encounter difficulties. These are addressed in detail. Chapter 8 describes the outlook for future investment returns and its impact on asset allocation. Against this background I discuss how credit can be incorporated into the portfolios of various types of institutional investor each of which has different objectives and constraints. We examine the risk profile of conventional long-only corporate bond funds, hedge funds trading credit as an underlying strategy and CDO (collateralised debt obligation) managers. Chapter 9 follows on from Chapter 8 by showing how particular credit products can enhance private client portfolios. Specific examples are discussed and we examine both the risks and opportunities from each. Chapter 10 examines the role of the insurance companies in the credit markets. This chapter should be of interest to insurers themselves and the general reader who wishes to understand the insurance market as an underwriter of risk. I highlight some of the legal and regulatory issues that influence the way in which insurance companies conduct their business and describe why their perspective on pricing and risk may differ from banks. The concluding Chapter 11 draws together these strands and provides some indication of the future development of this complex market.

It is not absolutely necessary to read the text in the order in which I have written it. I believe that readers should understand the technical details of individual products, the implications of combining them in a portfolio and the market dynamics before any discussion of the strategic implications of credit portfolio management. This is why I have deferred discussion of practical issues facing the different categories of investor until Part III. Although



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I believe this is a sensible framework, readers may prefer to approach it differently and focus initially on those sections where their greatest interest lies.

To assist readers in navigating through the text I will provide some guidance here which may help them match their interests and achieve optimal use of their time. Experienced commercial bankers who wish to concentrate on matters relating to bank portfolio and capital management might be advised to read Chapter 7 first and then Parts I and II in sequence. Private client and institutional fund managers may wish to start with Chapters 8 and 9 (which are closely related in subject matter) and then progress through the rest of the book in the order of the text. Readers interested in the insurance market may begin with Chapter 10 before getting to grips with the technical aspects of Parts I and II. A generalist reader who prefers to start with the strategic issues could well assimilate Part III before Parts I and II to provide a 'soft landing' before tackling the technical product details.



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