TW3421x - 2.4 - Summary Week 2

Ok, so, during the last week we have considered the different approaches we can use to assess credit risk under the Basel Framework.

Obviously, for the moment, in quite general terms, because we first need to introduce new tools in order to better specify the different models we can actually use.

But we have seen that we have three major approaches: the standardized approach, and the two internal-rating based approaches, that is to say the Foundation and the Advanced internal-rating based approach.

For what concerns the Standardized approach, we have seen that this approach is the simplest approach we can use in the Basel Framework. And essentially it relies on the computation of a quantity, which is called Risk-weighted Assets; and this involves essentially the summation of very simple quantities. Essentially the principal amounts by some risk weights.

The formula we have seen together also includes a second part - you remember, the summation in j, that is to say the part relative to the credit equivalent amount.

Ok, in any case, what we have said is that in the Standardized approach the risk weights are provided by the regulator, and the standardized approach is essentially meant for small banks, that do not have the money to invest in internal models, or banks that do not meet the minimum requirements for the internal-rating based approach.

For what concerns the internal-rating based approach, we have seen together that there are some parameters, some functions, and some minimum requirements, that have to be taken into consideration by banks, when developing their approaches.

Everything will be much more clear later on. For example, next week we will start introducing the Value-at-Risk, then we will introduce credit ratings in Week 4, and from that point on, we will really enter into the real modeling of credit risk.

For the moment, I just want you to understand the big picture, which is behind credit risk management, and then we will introduce more and more details to fill in all the gaps.

At the end of the course, you will have a complete vision of credit risk management. At least, the basics of credit risk management.

Ok, in this week, we have also seen an introduction to R, the statistical programming language. And I hope you will invest some time to familiarize with R.

Because starting from next week, with the Value-at-Risk, we will start using R in our computations.

So, see you next week. Goodbye.