PENHALLOW ASSOCIATES LIMITED

A Financial Knowledge Company

Risk Adjusted Return on Capital and the Sharpe Ratio

Virtual Learning or Classroom Training
Duration 6 Hours,
Course Price: On Request

Location: (UK) Virtual Learning Live Environment via Video Communication.

To book, or, require more information. Please contact Alan Penhallow;

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This programme may be of interest to your colleagues.

www.penassco.co.uk

The Aim of this one day course is to provide you with the tools and skills to develop transfer pricing models that price in the major financial risks and to calculate Risk Adjusted Return on Capital so that profitability is maximised.

Agenda.

In this course, you will;

Understand how Risk Adjusted Return on Capital contributes to the success of any organisation.

Develop models for Transfer Pricing and Risk Measurement.

Illustrate the application of the Sharpe ratio.

Examine the pitfalls in the Basel Accord and the International Financial Reporting Standards and their impact on profitability

Ideally, delegates should bring laptops with excel spreadsheets and calculators. However, there will be group exercises which will allow delegates to share laptops.

Introduction

Recent changes in the Basel Accord and International Financial Reporting Standards have directed the attention of risk managers on whether the overemphasis on too much regulation is eating into the profitability of international banking. Following the banking crisis for instance, banks are now required to tie up vast fortunes in liquid assets, often at very low or negative interest rates.

The regulations also dictate, through a potentially flawed weighing system, where banks should or should not invest. This interference in the market place can only lead to an oversupply in regulatory approved areas, and also force banks to avoid profitable business lines which are under-priced relative to their risk. It is no coincidence for instance that banks, during the recent banking crisis, lost vast fortunes through investment in mortgage backed property, government bonds and triple A rated structured products, the exact areas that the regulators encouraged.

Unfortunately, banks are relying on international accounting rules and Basel weighting systems to decide where and where not to invest and are setting limits and designing incentive schemes around these flawed rules.

Fortunately, for banks who have a thorough understanding of the flawed regulations, there are ways to find investment opportunities that are under-priced, thereby providing huge rewards for relatively little risk. This course will help you to structure your banks' limit setting and incentive system to focus on those areas. We examine, through the Sharpe ratio how banks can simulate the strategies of very successful hedge funds whilst staying within the remit of banking regulation and we show how through early warning signals, banks can avoid investments that are overpriced. We also examine how to set up an effective Funds Transfer Pricing system.

Topics covered will include:

- **Basic bank business lines (risk and reward profile)**
  Sharpe Ratio
  How hedge funds measure risk rewards
  Impact of diversification on risk reward ratio
  Risk measurement and setting a policy for risk tolerance

- **Estimating profits from business lines**
  Banking book – Interest margin and credit risk
  Trading book – volatility and trend analysis
  Diversification and profits forecasting
  Risk premium and profit generation
  Cushion capital

- **Establishing the cost of capital from various financial sources**
  Libor and the yield curve
  Premium for operational and liquidity risk
  Swap rates
  Credit spread

- **Risk Adjusted Return on Capital**
  Risk reward profile
  Transfer pricing
  Credit default rates
  Volatility v Risk premium
  Implied volatility

- **Measuring Market Risk, Credit Risk, Operational Risk and Liquidity risk**

  Interest, FX, Equity and commodity risk measurement through Value at Risk

  Stress analysis and liquidity risk

  Credit spread and credit volatility

  Operational risk profile and complexity of products

- **Offsetting risks from hedging, diversification and the risk transfer through securitisation and credit derivatives**

  Correlation and natural diversification

  Insurance risk reduction

  Transfer of risk through securitisation

  Credit risk transfer through credit default swaps and Total Return Swaps

- **Risk reward profile**

  Setting risk tolerance levels

  Function of Trading, Middle office and back office

  Impact of bonuses on risk reward profile

  Lessons from the banking crisis

- **Regulatory requirements on Operational, Liquidity, Market and Credit risk measurement and mitigation**

  Basel Accord – its strengths and weaknesses

  Allocation of capital to various industries

  Impact of too much and too little regulation

  Opportunities for hedge funds

- **Tier One and Tier Two capital**

  Permanent capital

  Gearing

  Leverage

  Convertible securities

Trainer Profile

Cormac Butler is currently an active equity and options trader and a former consultant with Lombard Risk Systems London and has also worked with Peat Marwick and PricewaterhouseCoopers.

He has considerable international experience as a training consultant in derivative accounting, Corporate Finance and Derivative Mathematics, working with major banks including Banquet BNP Paribas.

He has conducted in-house courses Morgan Stanley, PriceWaterhouseCoopers (Holland), Investec (South Africa) and ABB Switzerland and Asian Development Bank. In addition, he has worked for IIR and Euromoney in Singapore, Hong Kong, Thailand, America and Saudi Arabia.

Cormac graduated from the University of Limerick, Ireland with a degree in Finance He has recently published Mastering Value at Risk (Financial Times Pitman) which is currently on the best sellers list (for Risk Management books) with Amazon.com, Gloriamundi.org and Financial World Bookshop (London). He has also published Accounting for Financial Instruments by Wiley.

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