Risk Management at Wellfleet Bank: All That Glitters Is Not Gold

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AGENDA

01-Wellfleet Bank Overview

Founded in

1847

in London, initially serving Asian and African colonial outposts during the British Empire.

Transformed into a global bank between 1960 and 1990, expanding into North America and Europe.

Faced **challenges during the 1989–1992** European property and credit crisis, leading to a strategic reorientation in the 1990s.

Refocused on emerging markets, suspending non-core activities in Europe and North America

By 2008, Wellfleet operated in **78 countries**, with a strong presence in Asia (South Korea, India, Pakistan, and China).

Core Businesses:
Corporate Banking: 58% of pre-tax profits, 72% of assets.
Consumer Banking: 42% of pre-tax profits, 28% of assets.

Aggressive growth strategy in corporate banking, focusing on large-scale transformational deals.

02- Strategy and Risk Management

Wellfleet 's Strategy

Aggressive Growth in Corporate Banking

Focus on large-scale syndicated/leveraged loans

No investment banking arm; relied on corporate banking for growth.

→ Goal: **Become a top-tier player in global corporate finance.**

Emerging Markets Focus

Shift from Europe/N. America to Asia & Africa (e.g., South Korea, India, South Africa).

Competitive edge: "First-world compliance standards" in high-risk regions

Transformational Deals

Pursues high-reward, high-risk clients (e.g., Gatwick Gold Corp).

Aims for long-term relationships + cross-selling (e.g., hedging, syndication fees).

Risk Management Framework

Independent Risk Function

The risk team operates separately from business units to avoid bias.

Group Credit Committee (GCC) has the final say on approvals.

Regulatory Alignment

Complies with Basel II (capital reserves tied to risk exposure).

Data-Driven + Judgment-Based

Using metrics like Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD), but balances with qualitative factors (e.g., reputational risk, industry trends).

Executive Oversight

Group Risk Committee monitors mega-deals.The Board Audit Committee ensures governance.

02- Strategy and Risk Management

Is Wellfleet's Risk Management Process Appropriate?

- **Balanced approach:** Combines quantitative models with qualitative judgment.
- **Independent risk function:** Ensures unbiased risk assessment.
- **Comprehensive oversight:** Multiple layers of approval and risk committees.
- **"No-surprises" culture:** Senior executives are actively involved in risk oversight.

- **Increasing workload:** The Group Credit Committee faces a growing volume of large credit proposals.
- **Potential bottlenecks:** Reliance on a small group of senior executives could slow decision-making.
- **Tension between risk and business units:** Overly conservative risk assessments could stifle growth.

03- Mega-loans

What are the challenges posed by mega-loans ?

Due Diligence Complexity

Can the bank accurately assess risks associated with mega-loans ?

Because of the higher amounts of capital and risk involved, a mega-loan requires a more rigorous and cautious loan granting assessment. There is a need for deeper expertise and knowledge about the industries, the markets, the clients.

Credit Risk and Risk Management

Does the bank have the capacity to manage mega-risks ?

A mega-loan represents a mega-risk for banks. A default means significant financial losses for banks. A bank's financial health or/and survival can be significantly impacted. "If a billion-dollar deal went wrong, it could sink the ship."

Regulatory Constraints and Capital Strength

Does the bank has adequate capital buffers to withstand mega-loans defaults ?

Regulators require banks to set aside and manage capital reserves commensurate with the riskiness of their activities. Banks must maintain higher capital reserves for mega-loans.

Should Wellfleet Bank get involved in mega-loans ?

The bank is growing and has a strong risk management system. Mega-loans can be profitable.

Wellfleet's Financial Strength

- Wellfleet pre-tax profits surpassed $4 billion for the first time in its history in 2007
- In 2007, the bank has total opearating assets of $329 billion
- The bank enjoyed substancial growth in both retail and corporate lending activities
- The Corporate Banking Group has a negligible bad debt provisions

Risk Management at Wellfleet

- An independent risk management function that analyses proposals' risk and reward and sets the composition of the portfolio
- A well-structured risk management process with hierarchy between the different committees and officers. (Cf. Alpine Pass for credit applications)
- Frequent meetings to monitor the deals and their compliance
- A periodic review of the corporate loan portfolio

Wellfleet's Risk Assessment Strategy

- Both qualitative and quantitative risk information
- Scientific risk measurement : calculation of expected loss, risk adjusted revenue and risk adjusted profit
- Application of the internal rating models along with ratings from credit-rating agencies

Entering the Mega-Loans Market

PROS

High Revenue Potential:
mega-loans generate substancial interest income and fees

Reputation and Market Positioning:
the bank can attract more high-profile corporate clients and compete with bigger players

Stronger Relationship with Clients:
mega-loans help build long-term relationships with clients, which could lead to other revenue streams

→ Reinforce the bank’s growth and success

CONS

High Default Impact:
a default causes significant financial losses and could threaten the bank’s survival

Regulatory and Liquidity Constraints:
the bank must maintain higher capital reserves, which limits investments in other profitable opportunities

Market Sensitivity:
high-profile borrowers are highly exposed to economic downturns, geopolitical risks, which could affect loan repayments

How can the bank mitigate the risks ?

Loan Syndication: spread the risk across multiple banks to not bear the full brunt of a potential default

Stress Testing and Ongoing Monitoring: assess the impact of a default on the bank's financial situation and continuously monitor the borrower's financial health

Loan Covenants and Collateral Offerings: include protective clauses in loan agreements (financial metrics, collateral)

Hedging: use financial instruments to hedge against potential borrower default

04 - Credit risk

How does Wellfleet manage its credit risk?

Independent risk function

Risk management operates **separately** from the business side to ensure objective assessments.

Structured risk oversight

The Group Risk Committee oversees credit risk, along with **seven other committees** managing different risk types (market, operational, compliance, country, reputational, and business).

Portfolio risk monitoring

Credit officers actively **monitor risk concentration** (for example, industry exposure should not exceed 8% of risk-weighted assets). They **adjust** lending strategies **based on market conditions**.

Risk-adjusted performance metrics

Wellfleet adjusts performance metrics to include the riskiness of the credit.

- Risk-adjusted revenue (RAR)
- Economic revenue (ER)
- Economic profit (EP)

Credit risk assessment framework

Uses a mix of **quantitative models** and **qualitative judgment**, comparing internal and external **credit ratings**.

Key metrics: probability of default (PD), loss given default (LGD), exposure at default (EAD) , expected loss (EL).

04 - Credit risk

What is the credit approval process?

“Alpine Pass” (Credit Officer Hierarchy)

- A **multi-level approval structure** where **credit officers** at different levels review loan proposals based on size and risk level.
- More experienced officers handle larger and riskier deals.

Relationship managers (sales team) propose loan deals, aiming for business growth.

Senior Credit Officers evaluate the proposal’s revenue potential and risk exposure.

Group Credit Committee (GCC), which is the highest approval authority, makes final decisions on mega-loans. They can approve loans of any size within regulatory contraints, with no explicit upper limit.

Ongoing risk oversight: the Board’s Audit & Risk Committee ensures the credit process aligns with risk appetite.

04- Credit risk

What are the advantages and disadvantages of this process?

Advantages

Independent risk function

Ensures objectives loan assessments and prevents undue influence from sales team.

Comprehensive risk analysis

Uses both quantitative models and expert judgment to assess credit risk.

Structured approval process

Multi-level review "Alpine Pass" balances risk control with business growth decisions.

Proactive risk monitoring

Tracks industry concentration and portfolio exposure, adjusting strategies to mitigate emerging risks.

Disadvantages

Slow decision-making

The multi-level approval system "Alpine Pass" delays loan decisions, making the bank less agile in competitve markets.

Tension between sales and risk team

The strict risk function can frustrate relationship managers, potentially leading to missed business opportunities.

Fragmented risk oversight

Different risk types are reviewed separately, making it harder to get a holistic view of overall risk.

Inflexibility in risk models

While Wellfleet emphasizes risk models, relying too much on them can overlook industry changes and unique client situations, making decision-making rigid.

05- Should Wellfleet accept Gatwick Gold loan?

Computation of Economic Profit

Expected Loss

Expected Loss = Probability of Default * Exposure at Default ($) * Loss Givel Default (%) = 0.39% * $1Billion * 52.25% = $2,037,750

Total Revenue

Total Revenue = Interest Income + Fee Income = ($0.5 Billion * 425 bps) + ($0.5 Billion * 525 bps) + ($1 Billion * 30bps) = $21,250,000 + $26,250,000 + $3,000,000 = $50,500,000

Risk Adjusted Revenue (RAR)

RAR = Total Revenue - Expected Loss = $50,500,000 - $2,037,750 = $48,462,250

Economic Revenue

Economic Revenue = RAR - Net Capital Charge = $48,464,250 - $3,800,000 = $44,662,250

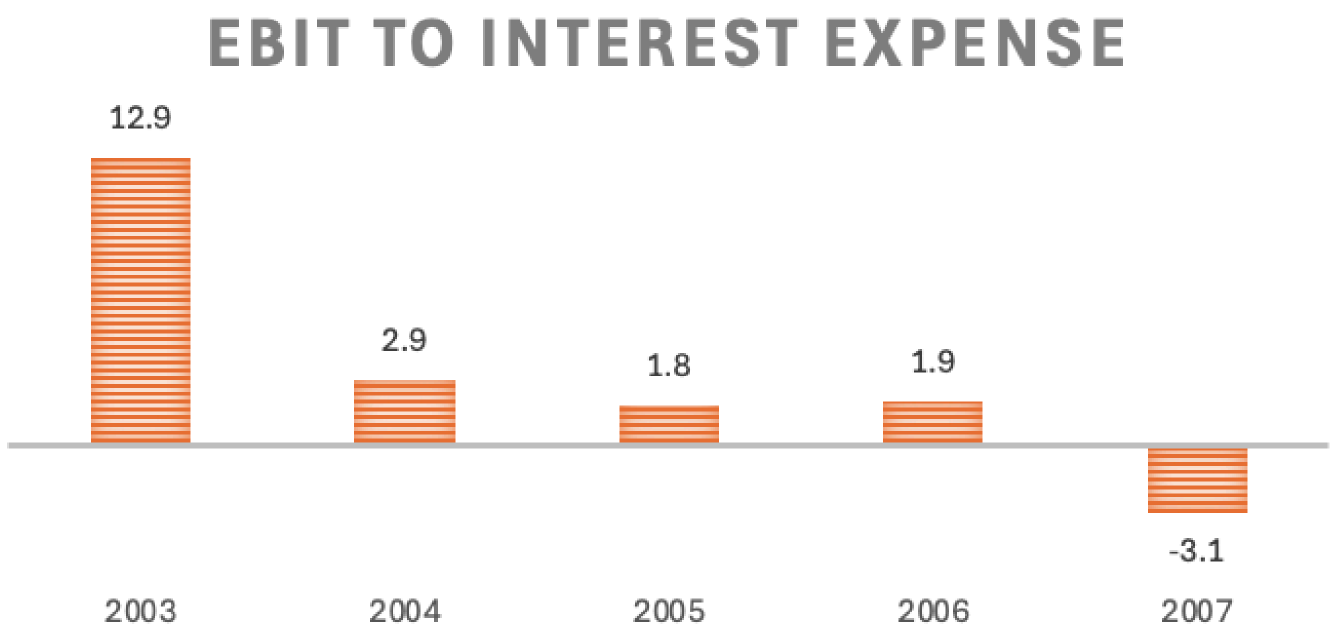
Economic Profit

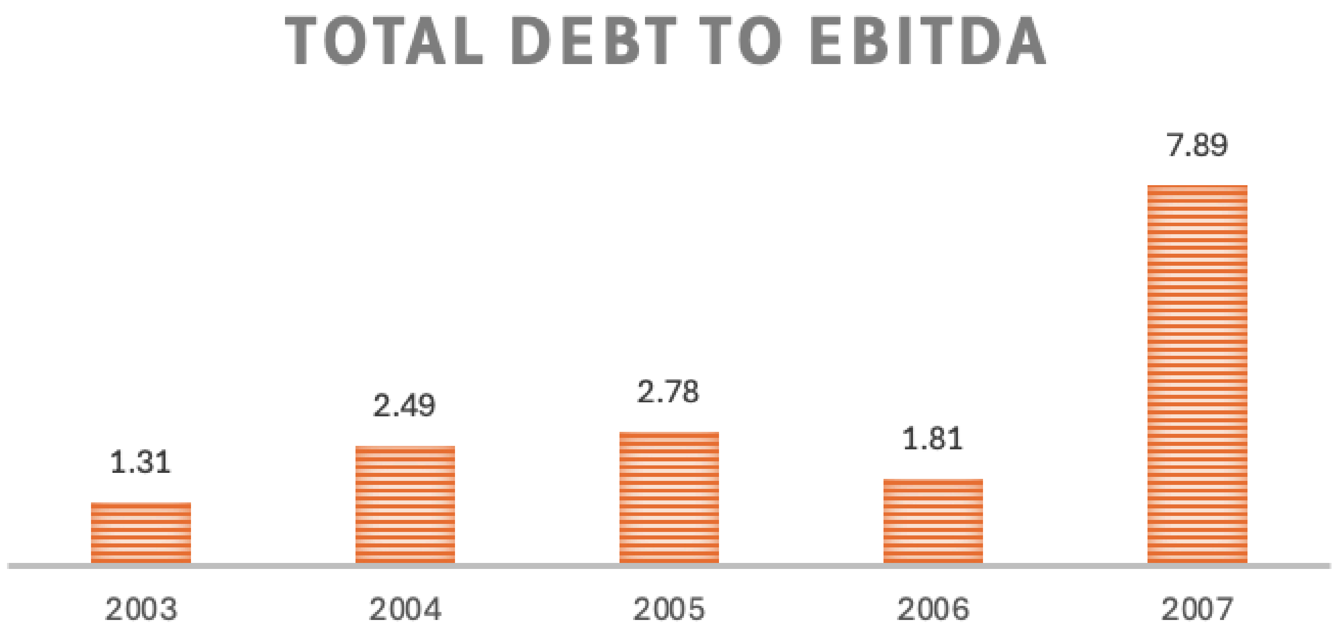
Economic Profit = Economic Revenue - Cost - Tax = $44,662,150 - $500,000 - $12,000,000 = **$32,162,250**

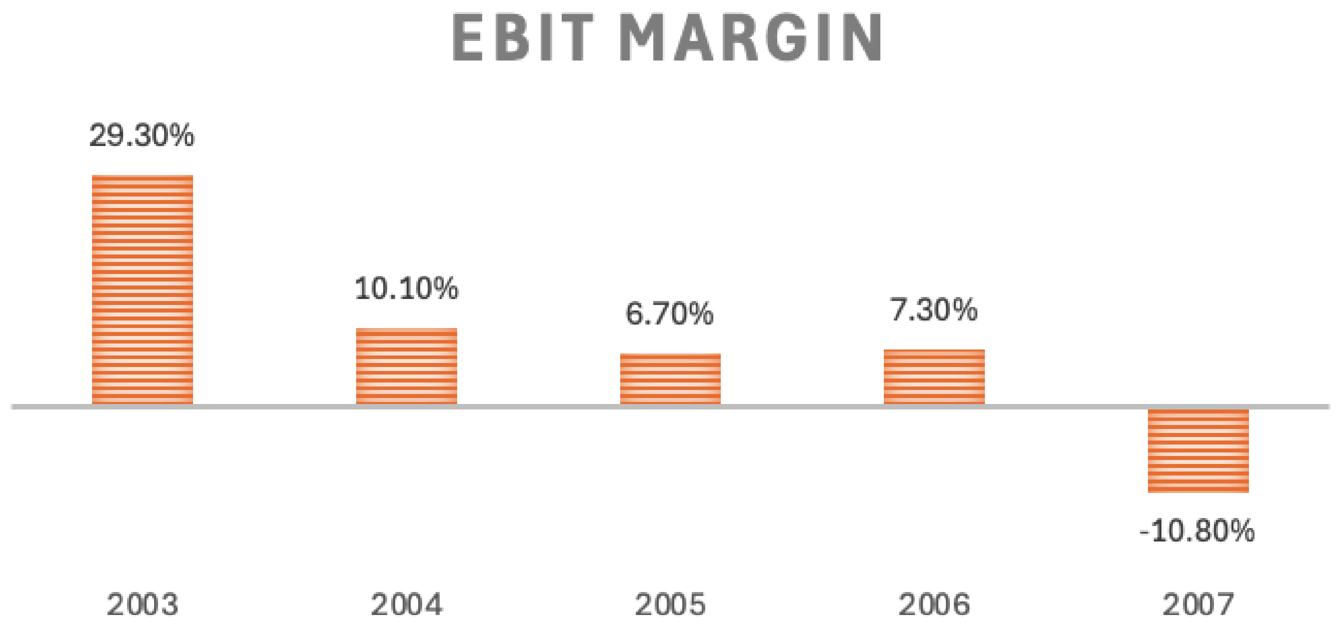
Should Wellfleet accept the proposal?

Analyse of GGC Financials

- GGC was in a strong financial position in 2003 but deteriorated significantly by 2007.
- The decline of EBIT Margin and EBIT to Interest Expense ratios, suggests inability to cover interest expenses, lower profitability and rising financial risk.
- The increase of Debt to EBITDA ratio from 1.31 to 7.89 indicates to higher leverage and financial risk and consequently reduced capacity to repay debt
- By 2007, the company was in severe financial trouble, as seen by negative EBIT margins and inability to cover interest expenses.







Should Wellfleet accept the proposal?

What are the strengths and weaknesses?

Strengths

Economic Profit

The positive economic profit of $32,162,250 suggests that the proposal is financially viable.

Strategic relasionship potential

The loan could position Wellfleet as a lead bank for GGC, opening doors to future mandates.

Improved management team

The company has appointed a new experienced management team, with plans to undo hedge positions and improve profitability

Weaknesses

Weak financial position

Key financial ratios indicate that the company experienced rising unprofitability, excessive leverage, and a declining ability to meet its debt obligations.

High exposure to gold price volatility

The company is exposed to gold price volatility, increasing cash flow instability. With high fixed costs, gold mining companies are highly sensitive to price fluctuations.

Political risks

72% of production is in African countries, especially South Africa, where there is pressure for mine safety, BEE regulations and social risks

Decision: Rejection of Credit Application

THANK YOU