

# Global Credit Review

## Message from the Editor

**T**he Risk Management Institute (RMI), a university-level research institute of the National University of Singapore, strives to become a globally recognized knowledge centre where scholars, regulators and industry professionals gather to advance cutting edge knowledge. By transferring knowledge to the community, we aim to enhance the practice of financial risk management.

We contribute to this objective by publishing this first annual edition of *The Global Credit Review* which targets finance professionals, policy makers and academics with an interest in credit markets. *The Global Credit Review* will provide an overview of the most important developments in global credit markets and the regulatory landscape, cover theoretical and empirical research on credit ratings and credit risk, and report on recent findings and evolutions of the RMI Credit Rating Initiative.

In the current macro-economic environment, managing risk is no longer an option, but a necessity. The world economy is experiencing high volatility with economic dominance shifting and well established practices being challenged. Future economic growth prospects, primarily supported by emerging economies, are currently unsettled by high commodity prices that may cause unchecked inflation and pose a risk to growth. To address the former, we expect monetary actions that differ vastly across nations and as such increase global imbalances. In addition, the financial stress in Europe is unlikely

to change as long as doubts persist about some sovereigns' solvency. The risk of debt restructuring remains, and high sovereign spreads might later contaminate other European countries whose solvency credentials look sound at this moment. The overheating pressures in emerging markets persist, and restrictive monetary policy and fiscal tightening in emerging countries such as Brazil and China have no clear end in sight. Finally, the concern over the US fiscal deficit looms ever larger, and the political squabbling on deficit reduction only adds uncertainty to the market.

In this turbulent environment, credit rating agencies (CRAs) play an essential role. They can make or break a government, for example by downgrading Greek debt to speculative grade. However, the landscape is expected to change. Since the onset of the financial crisis, CRAs have been the focus of considerable scrutiny from regulators, policymakers, investors and researchers. As part of the initiative to strengthen the resilience of the present financial system, many governments and organizations have signaled or have already taken action to strengthen the regulatory framework governing the credit rating industry. As a result, the post-crisis era is witnessing the enactment of several regulations that are intended to fundamentally change the operations of CRAs. We expect that CRAs will continue to play an important role in financial markets; however, the rules of the game must change.

*The Global Credit Review* is part of the Credit Rating Initiative that RMI commenced in 2009 as a constructive response to the criticisms aimed towards CRAs. The primary objective of the Credit Rating Initiative is to advance the state of research and development in the critical area of credit rating systems.

The Credit Rating Initiative also includes an operational probability of default system, which started producing daily probabilities of default for exchange listed firms in July 2010. As of this issue of *The Global Credit Review*, 30 different economies in Asia, Asia-Pacific, North America and Western Europe are covered. The probabilities of default for 2,200 individual firms, and aggregate results for almost 30,000 firms are publicly available. The implementation of this system was undertaken to demonstrate the operational feasibility of the system and as a source of credit information for credit professionals in financial institutions, corporate treasury departments and regulatory agencies.

This first edition of the Global Credit Review starts with an article by Dr.

Dipinder Randhawa entitled ‘The Past, Present and a Possible Future Direction for the Credit Rating Industry’. In a second article ‘A New Regulatory Framework for Credit Rating Agencies’, we highlight the most recent attempts at CRA regulation that have recently been undertaken by authorities worldwide. We then proceed with an article from Dr. Amadou Sy on ‘Managing the Risk of Credit Rating Downgrades: Lessons for Investors from Recent Crises’. The volume further provides a review article on ‘Statistical Credit Rating Methods’ by Prof. Jin-Chuan Duan and Prof. Keshab Shrestha. The last article ‘NUS-RMI Credit Rating Initiative: Technical Report’ gives detailed technical information on implementation and performance of the RMI Credit Rating Initiative system. For a more elaborate discussion and update on our default predictions produced thus far we refer readers to the forthcoming *Quarterly Credit Report*.

We hope you will enjoy reading this first edition and welcome your feedback on *The Global Credit Review* and our Credit Rating Initiative.

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*The Global Credit Review, (ISSN# 2010-4944), is published annually by the Risk Management Institute of the National University of Singapore, 21 Heng Mui Keng Terrace, Level 4, Singapore 119613. First issue published in July 2011. Copyright © 2011 by National University of Singapore. All Rights Reserved. The responsibility for facts and opinions in this publication rests exclusively with the authors and their interpretations do not necessarily reflect the opinion of NUS.*