

EVALUATING RATING AGENCIES:
RECENT DEVELOPMENTS AND LESSONS
FROM THE HIGH YIELD BOND MARKETS

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Evaluating Rating Agencies: Recent Developments and Lessons from the High Yield Bond Market

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(Discussion Outline)

Linkage to Corporate Bond Default Rates

- ? Traditional Annualized Results
- ? Cumulative and Mortality Approaches
- ? 1999 Update - Some Startling Evidence

Sanctioning of External Rating Agencies by the BIS for Capital Allocation on Credit Assets for Banks

- ? Sovereign, Bank and Corporate Debt Loans
- ? Bucket (Rating) Approach
- ? Comments

Performance of Rating Agencies in Asian Crisis

- ? Corporate Governance vs. Capital flows
- ? Could Selected Country Problems Have Been Predicted

RATING AGENCY HISTORY: SELECTED ASIAN COUNTRIES
(1996 - 1999)

<u>Dates</u>	THAILAND				INDONESIA				SOUTH KOREA			
	<u>Moody's</u>	<u>S&P</u>	<u>Thomson</u>	<u>Fitch</u>	<u>Moody's</u>	<u>S&P</u>	<u>Thomson</u>	<u>Fitch</u>	<u>Moody's</u>	<u>S&P</u>	<u>Thomson</u>	<u>Fitch</u>
November 1996	A2	A	A-	-	Baa3	BBB	BB+	-	A1	AA-	AA-	AA-
Downgrade	Apr.1997 (1)	Sept. 1997	Sept. 1997	-	Dec. 1997	Oct. 1997	Upgrade	Dec. 1997	Nov. 1997	Oct. 1997	Nov. 1997	Nov. 1997
November 1997	A3	A-	A-	-	Ba1	BB+	BB+	BB+	Ba1	BB+	BBB	BB+
1998 (Increase in Rating)	Ba1 (4)	BBB- (3)	BBB- (3)	BBB-	B3 (5)	CCC+ (6)	C- (6)	B- (5)	Ba1 (6)	BB+ (7)	BBB (6)	BB+ (7)
August 1999	Ba1	BBB-	BBB-	BBB-	B3	CCC+ C	C	B-	Baa3	BBB-	-	BBB

Changing Regulatory Environment

- 1988 Regulators recognized need for risk-based Capital for Credit Risk (Basle Accord)
- 1995 Capital Regulations for Market Risk Published
- 1996-98 Capital Regulations for Credit Derivatives
- 1997 Discussion of using Credit Risk Models for selected portfolios in the banking books
- 1999 New Credit Risk Recommendations
 - ? Bucket Approach - External & Internal Ratings
 - ? Post March 2000 into Effect
 - ? Postpone Internal Portfolio Models

The Importance of Credit Ratings

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- ? For Risk Management in General
- ? Greater Understanding Between Borrowers and Lenders
- ? Linkage Between Internal Credit Scoring Models and Bond Ratings
- ? Data Bases - Defaults and Migration Statistics Based on Original and Continuous Rating Bond Ratings (Moody's and S&P)
- ? BIS Standards on Capital Adequacy
8% Rule now regardless and Risk Bucket Approach
Model Approach - Linked to Ratings
- ? Credit Derivatives
Linked to Current Rating
Default and Recovery Rates
- ? Bond Insurance Companies'
Rating (AAA) of these Firms
Rating of Pools that are enhanced
Rating of Asset-Backed Securities (ABS)

Proposed BIS Risk Weighting on Credit Assets

Claim		Assessment					
		AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Sovereigns		0%	20%	50%	100%	150%	100%
Banks	Option 1 ¹	20%	50%	100%	100%	150%	100%
	Option 2 ²	20%	50% ³	50% ³	100% ³	150%	50% ³
Corporates		20%	100%	100%	100%	150%	100%

¹Risk weighting based on risk weighting of sovereign in which the bank is incorporated.

²Risk weighting based on the assessment of the individual bank.

³Claims on banks of a short original maturity, for example less than six months, would receive a weighting that is one category more favorable than the usual risk weight on the bank's claims.

