

# The Licensing Examination for Securities and Futures Intermediaries

## Paper 10 Credit Rating Services

### Syllabus

(Effective from 1 December 2018)

#### Topic 1: Overview of credit as a financial discipline

- 1 What is Credit?
  - From a legal perspective
  - From an economic perspective
  - From a social perspective
- 2 Credit (debt) as a financial investment
  - Fundamental difference from equity
  - Different types of basic credit products
  - Implicitness of credit in all financial transactions
- 3 Financial asset risk: a function of certainty
  - Credit risk and market risk: similarities and differences
  - Credit quality and risk tolerance
  - Credit quality with financial statements
  - Debt capital markets

#### Topic 2: The credit rating industry

- 1 Credit rating as a relative measure of credit risk
  - Credit ratings as a measure of payment certainty
  - Credit ratings as default risk grading
- 2 How credit ratings respond to the market environment
  - The evolution of key rating distinctions
  - Key developments that drive rating processes and products

- 3 Who makes credit ratings?
  - Credit rating agencies as the neutral provider of credit value
  - The quasi-regulatory role of CRAs
  - The Big Three and their rating scales
  - Other types of CRAs and credit analytics providers
  - The credit rating agency industry today

#### Topic 3: The credit rating process

- 1 Elements of the credit rating process
  - Inside the CRA: internal organisation of duties and workflow
  - Source material used in the rating analysis
  - How is a rating done?
- 2 Quality control issues
  - Independent role of the credit rating agencies
  - Internal sources of quality control
  - External sources of quality control
  - Principles of integrity, transparency, responsibility, good governance in action
- 3 Institutionalising surveillance, backtesting, reporting and record-keeping
  - Duties of the rating agency as an independent provider of credit quality
  - Surveillance, backtesting, reporting and record-keeping: internal quality controls
  - External regulation on CRA self-evaluation
- 4 Making and changing rating methodologies or criteria
- 5 Addressing the needs of users of credit ratings
  - Who are users of credit ratings?

- Fostering awareness of credit ratings and their uses
- Explaining the basis of a rating
- Channels of communication
- Speaking to different constituencies
- Inappropriate communications
- Handling complaints

#### Topic 4: Corporate credit ratings

- Analysing corporation credit quality
  - Balance sheet and financial strength
  - Cash flow position
  - Management capacity and other intangibles
  - Industry-imposed constraints on growth and profitability
  - Covenants
  - Extensions of the corporate paradigm
- Measures of corporate credit strength
  - Key ratios associated with corporate credit strength and ratings behavior
  - Industry-specific benchmarks
  - Case illustrations
- Special topics for bank and financial institution analysis
  - Measures of financial institution health
  - Financial institutions and governments
  - Commercial and policy-oriented financial institutions
- Benchmarking credit quality against aggregate measures
  - Bond default studies
  - Rating transition matrices
  - Option theoretic pricing
- Keeping corporate credit rating freshness
  - Challenges to the going-concern

assumption

- Through-the-cycle versus Point-in-time ratings

6 Rating corporations in emerging economies

- Corporate credit rating: Issues on China enterprises

#### Topic 5: Structured finance credit ratings

- Key developments associated with the rise of structured finance
- Defining structured finance and securitisation
- Types of transaction structures
- Rating structured securities
  - How the process of rating structured securities differs from that of corporate bonds
  - Methodological differences between agencies
  - Methodological differences for different structural types
- Benchmarking credit quality: structured securities
  - Rating performance
  - Risks to structured transactions performance

#### Topic 6: Sovereign credit ratings

- Defining sovereign ratings
  - Differences between sovereign risk and country risk
  - Domestic bond ratings versus foreign bond ratings
  - Importance of sovereign ratings
  - Municipal ratings
- Basis of sovereign credit ratings
  - Determinants on sovereign default cases
- Methodological differences between the NRSROs
  - Balance sheet versus income-based approaches

- Sovereign solvency and access to foreign exchange
- Sovereign interference
- The payment system
- Domestic scale ratings
- Predicting CRAs' sovereign ratings
- Rating differences among CRAs

4 Do sovereign ratings work? Evidence from the rating agencies

- Issue on CRAs validating sovereign ratings
- CRAs' ability to predict crises
- Sovereign ratings as forward-looking indicators

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