

# The Licensing Examination for Securities and Futures Intermediaries

processes and products

## 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 Statement of financial statements position, income statement and cash flow statement~~
  - 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

- 3 Who makes credit ratings?
  - Credit rating agencies as the neutral provider of credit value
  - The quasi-regulatory role of CRAs
  - The ~~“Majors”~~ 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 What-rating done? agency analysts do~~
- 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

- 1 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
- 2 Measures of corporate credit strength
- Key ratios associated with corporate credit strength and ratings behavior
  - Industry-specific benchmarks
  - Case illustrations
- 3 Special topics for bank and financial institution analysis
- Measures of financial institution health
  - Financial institutions and governments
  - Commercial and policy-oriented financial institutions
- 4 Benchmarking credit quality against aggregate measures
- Bond default studies
  - Rating transition matrices
  - Option theoretic pricing

- 5 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

- 1 Key developments associated with the rise of structured finance
- 2 Defining structured finance and securitisation
- 3 Types of transaction structures
- 4 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
- 5 Benchmarking credit quality: structured securities
- Rating performance
  - Risks to structured transactions performance

#### Topic 6: Sovereign credit ratings

- 1 Defining sovereign ratings
- Differences between sovereign risk and country risk
  - Domestic bond ratings versus foreign bond ratings
  - Importance of sovereign ratings
  - Municipal ratings
- 2 Basis of sovereign credit ratings
- Determinants on sovereign default cases
- 3 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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