

# The Licensing Examination for Securities and Futures Intermediaries

## Paper 10 Credit Rating Services

### Syllabus (Effective from 1 September 2021)

#### 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 risk of non-payment
  - Credit ratings as default risk grading
  - Limitations in use of credit ratings
- 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 opinion
  - Regulations pertaining to credit rating agencies
  - The Big Three and their rating scales
  - Other types of credit rating agencies 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 of credit rating agencies
  - Ongoing surveillance & modification of rating
- 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
- Communicating limitations of ratings

**Topic 4: Corporate credit ratings**

1 Analysing corporation credit quality

- Balance sheet and financial strength
- Cash flow position
- Profitability measures
- Management capacity and other intangibles
- Industry or sector factors
- Covenants
- Extensions of the corporate paradigm

2 Measures of corporate credit strength

- Key ratios associated corporate rating factors
- Industry-specific benchmarks
- Case illustrations
- Major adjustments to financial statements

3 Benchmarking credit quality against aggregate measures

- Benchmarking on group basis
- Market data for inferring credit risk
- Country ceiling

4 Rating corporations in emerging economies

- Corporate credit rating: issues on

China enterprises

**Topic 5: Bank and non-bank financial institution credit ratings**

1 Bank ratings

- Overview of bank rating scale, definitions and criteria
- Bank standalone assessment
- Parent and government support
- Support and structural analysis
- Country risk
- Country ceiling for bank ratings
- Factors on bank failures

2 Non-bank financial institution ratings

- Overview of NBFII rating scale, definitions and criteria
- Insurance companies
- Securities market makers and securities service providers
- Asset managers
- Fund ratings

**Topic 6: Public sector enterprise credit ratings**

1 Public sector enterprises and their debt instruments

- Definitions of public sector enterprises
- Examples of public sector enterprise debt instruments

2 General risk factors on rating PSE debt instruments

- Financial profile and revenue stability
- Management quality and operating risk
- Government supports
- Financial strength of governments

3 Ratings criteria of selected PSE debt instruments

4 Default history of public sector enterprises

- SOE and LGFV defaults in Mainland China

- Default cases of US public sector enterprises

### Topic 7: 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

- The payment system
- Local-currency scale ratings for emerging economies
- Relationship of sovereign ratings and macroeconomic factors
- Rating differences among credit rating agencies

### 4 Do sovereign ratings work? Evidence from the rating agencies

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

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### Topic 8: Sovereign credit ratings

- 1 Defining sovereign ratings
  - Differences between sovereign risk and country risk
  - Local-currency bond ratings versus foreign-currency bond ratings
  - Importance of sovereign ratings
  - Municipal ratings
  - Country ratings
- 2 Basis of sovereign credit ratings
  - General rating criteria of credit rating agencies
  - Determinants on sovereign default
- 3 Methodological differences between the NRSROs
  - Balance sheet versus income-based approaches
  - Sovereign solvency and access to foreign exchange