

# 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 certainty
  - 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 value opinion
  - The quasi-regulatory role of Regulation 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 on CRA self-evaluation
  - 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 imposed constraints on growth and profitability or sector factors~~
  - Covenants
  - Extensions of the corporate paradigm
- 2 Measures of corporate credit strength
- Key ratios associated ~~with corporate credit strength and ratings behavior~~ rating factors
  - Industry-specific benchmarks
  - Case illustrations
  - Major adjustments to financial statements
  - ~~3 Special topics for bank and financial institution analysis~~
  - ~~Measures of financial institution health~~
  - ~~Financial institutions and~~

governments

- ~~Commercial and policy-oriented financial institutions~~

- 43 Benchmarking credit quality against aggregate measures

### ~~Bond default studies~~

- ~~Rating transition matrices~~
- ~~Option theoretic pricing~~
- Benchmarking on group basis
- Market data for inferring credit risk
- Country ceiling

### ~~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~~

- 64 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**

- Public sector enterprises and their debt instruments
  - Definitions of public sector enterprises
  - Examples of public sector enterprise debt instruments
- General risk factors on rating PSE debt instruments
  - Financial profile and revenue stability
  - Management quality and operating risk
  - Government supports
  - Financial strength of governments
- Ratings criteria of selected PSE debt instruments
- Default history of public sector enterprises
  - SOE and LGFV defaults in Mainland China
  - Default cases of US public sector enterprises

### **Topic 57: 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 68: Sovereign credit ratings**

- Defining sovereign ratings
  - Differences between sovereign risk and country risk
  - Domestic Local-currency bond ratings versus foreign-currency bond ratings
  - Importance of sovereign ratings
  - Municipal ratings
  - Country ratings
- Basis of sovereign credit ratings
  - General rating criteria of credit rating agencies
  - Determinants on sovereign default-eases
- Methodological differences between the NRSROs
  - Balance sheet versus income-based approaches
  - Sovereign solvency and access to foreign exchange
  - ~~Sovereign interference~~
  - The payment system
  - Domestic Local-currency scale ratings for emerging economies
  - Predicting CRAs' Relationship of sovereign ratings and macroeconomic factors
  - Rating differences among credit rating agencies
- 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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