

Discussion of:

"Measuring the Quality and Consistency of Corporate Ratings across Regions"

by

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Disclaimer:

The views expressed are those of the speaker and not those of the BIS.

1 Why this paper?

- Do ratings mean the same thing across regions?
 - What are the purposes of ratings?
 - How can we measure ratings performance?
- Paper proposes several metrics related to:
 - Meaning (absolute risk); Accuracy (relative risk); Stability
- Important subject!
 - Global asset allocation; Pricing; Regulation

2 Overall impressions

- Methodology (ratings policy) and application (ratings decisions) can be distinguished
- Largely agree with metrics
 - Relative emphasis should be stated more clearly
- Some doubts about implementation in case study
- Can we really believe the results?
 - Too good to be true!

3 Loss rates are key for comparing meaning

- Ratings are intended to reflect:
 - Relative likelihood company will service its debt on time
 - Likely severity of loss
- Want to measure: Expected Loss at long horizons
- Proxy with: Ex Post Loss Rates averaged over long periods

	Aa	A	Baa	Ba
US	0.0	0.2	1.0	5.6
Europe	0.0	0.1	0.8	7.7

4 Spread as a metric is less convincing

- Endogeneity – different reliance on ratings in pricing across regions?
- Several components in spreads: expected loss, systematic risk, jump-at-default risk, liquidity
- A ratings puzzle: jump-at-default risk premia increase with better ratings!
- Ratio of spread to expected loss
(Amato and Remolona, "The Pricing of Unexpected Credit Losses"):

	Aaa	Aa	A	Baa
US	625.4	55.4	13.2	4.1
Europe	209.4	35.1	6.7	1.6

5 Is there enough data?

- By assumption, long samples are needed to assess ratings performance
 - IG: must look at long horizons – data covers 1+ credit cycles
 - HY: must identify permanent/transitory shocks – 5 years of data!
- Robustness? Ranking of default rates swings on one observation!
- Comparability: different evidence is presented for different periods
- Should compare ratings to average spreads over long periods
 - Paper uses 9 months of CDS data! ML OAS indices tell different story

Merrill Lynch Corporate Bond Indices
Average Option-adjusted Spreads
Period: 4 January 1999 – 20 May 2005
Maturity: 5–7 Years
(in basis points)

	Aaa	Aa	A	Baa
US	77	88	115	202
Europe	31	47	79	127

6 Too good to be true!

- Do aggregates hide important differences across markets?
- What about structural changes?
 - Size: European issuance (esp. high yield) took off in 1999
 - Composition, e.g., telecoms
 - Very different accounting ratios
 - Robustness going forward?
- Good luck or good analysts? TOO EARLY TO TELL!

7 Other issues

- Procyclicality?
 - Amato and Furfine (JBF, 2004) found little evidence of procyclicality in US corporate ratings controlling for firm-specific variables
 - Does this result hold in other economies?
- Consistency with EDFs?