XBRL
and
Credit ratings

Workshop on Improving Access

Financial Data on the Web

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Cate Long, Multiple-Markets

MULTIPLE-MARKETS

Credit ratings for the fixed income markets

- Credit ratings are "opinions" about the relative creditworthiness of fixed income securities or obligors.

- Embedded in many laws, regulations, contracts, and investment guidelines.

- Ratings are opinions about the risk of "default".

What's the market?

- Fixed income ~ bond ~ debt ~ credit

- A large, deep, quiet market

- Used by governments, corporations, financial institutions and sponsoring entities to raise funds

- These products fill the balance sheets of banks, pension and mutual funds, governments, individuals

US debt issuance 2Q/09

- Treasury >> $ 533 billion
- Federal agencies >> $ 119 billion
- Municipals >> $ 111 billion
- Corporates >> $ 418 billion
- Asset backed >> $ 49 billion
- Mortgage backed >> $ 648 billion
- Equity issuance >> $ 30 billion

SIFMA data

A bond =

- A debt instrument, also considered a loan, that an *investor* makes to a corporation, government, federal agency, or other organization (*issuer*)
- In which the issuer typically agrees to pay the investor the amount of the *face value* of the bond on a *future date*
- And to pay *interest* at a *specified rate* at *regular intervals*.

Bonds are underwritten...

- Terms of the issue are defined (size in dollars, the maturity, the approximate yield)

- Credit rating agencies are contacted and ratings developed

- Debt syndication desks at investment banks connect the seller and buyers

The underwriter distributes the deal

- Most offerings are oversubscribed

- Generally 90% of bonds are held to maturity

- Almost entirely an institutional client process

Investors

- Investors are usually institutions

- Pension funds, mutual funds, banks, foreign governments and overseas investors

<< Credit rated products >>

- Corporates
- Convertibles
- High yield
- MBS
- CMBS
- ABS
- CMO

- Commercial paper (CP)
- CDOs
- Repo
- Treasuries
- Agencies
- Municipals

Credit ratings and bond prices

Moodys.com
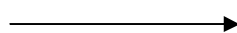**STANDARD &POOR'S**
FitchRatings KNOW YOUR RISK

< Caa1 >   < CCC+>   < CCC >

Underwriter ....➤   **Ford Credit** **Ford**   *8.70%.*

UNITED STATES DEPARTMENT OF THE TREASURY ⟶ Yield on Treasuries   *3.22 %*

Credit ratings agencies

Credit ratings as qualitative measures

- Credit ratings are forward looking opinions of credit worthiness.

- There are "relative" rankings of risk

- Rating agencies help investors evaluate the return they should receive.

- Higher risk should earn investors higher returns

Credit ratings as quantitative measures

- Some issuers default on their obligations

- Lehman, Bear Stearns and AIG were rated "A" at time of collapse (note only LB went BK)

- Rating agencies track the historical performance of ratings

- Quantifying defaults helps evaluate an individual firms performance and

- Helps compare the performance between rating agencies

CREDIT RATING DEFAULT PROBABILITIES (DP)

Based on 5 year historical median of Moody's KMV EDF's

		(Indicative Table *)			
Maximum Allowable Percentage)				7.50%	
Base Default Probability				0.06%	

Moody's	5 Year Median Default Probability	Tangible Net Worth or Net Asset Percentage	S&P	5 Year Median Default Probability	Tangible Net Worth or Net Asset Percentage
Aaa	0.020%	7.50%	AAA	0.020%	7.50%
Aa1	0.032%	7.50%	AA+	0.033%	7.50%
Aa2	0.040%	7.50%	AA	0.042%	7.50%
Aa3	0.056%	7.50%	AA-	0.059%	7.50%
A1	0.080%	5.60%	A+	0.084%	5.38%
A2	0.114%	3.94%	A	0.119%	3.80%
A3	0.144%	3.12%	A-	0.154%	2.92%
Baa1	0.182%	2.47%	BBB+	0.200%	2.25%
Baa2	0.230%	1.95%	BBB	0.259%	1.73%
Baa3	0.307%	1.47%	BBB-	0.367%	1.23%
Ba1	0.408%	1.10%	BB+	0.518%	0.00%
Ba2	0.544%	0.00%	BB	0.733%	0.00%
Ba3	0.848%	0.00%	BB-	1.215%	0.00%
B1	1.323%	0.00%	B+	2.014%	0.00%

Congress passes the Credit Rating Agency Reform Act of 2006

15E 1. (B) REQUIRED INFORMATION- An application for registration under this section shall contain information regarding--

(i) credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable) of the applicant;

SEC adopts rules for "performance statistics"

- Raters must publish default statistics on website

- Proposes possible extension of Edgar for firms default data

- Proposes the use of XBRL to expose individual ratings to public scrutiny

Current status of SEC rulemaking

- Adopts rule that 100% of issuer paid ratings in XBRL in 1 year

- Adopts rule that 100% of investor paid ratings in XBRL in 2 years

- Has <u>not</u> published list of XBRL tags yet

- Said on August 5th that raters can publish ratings in computer readable form until tags adopted

Default rates by industry groups

Default Rates by Broad Industry Group, 1970-1999

Energy, Transportation, Consumer Goods & Services See Largest Increase in '99

*Includes Sovereign and Miscellaneous.
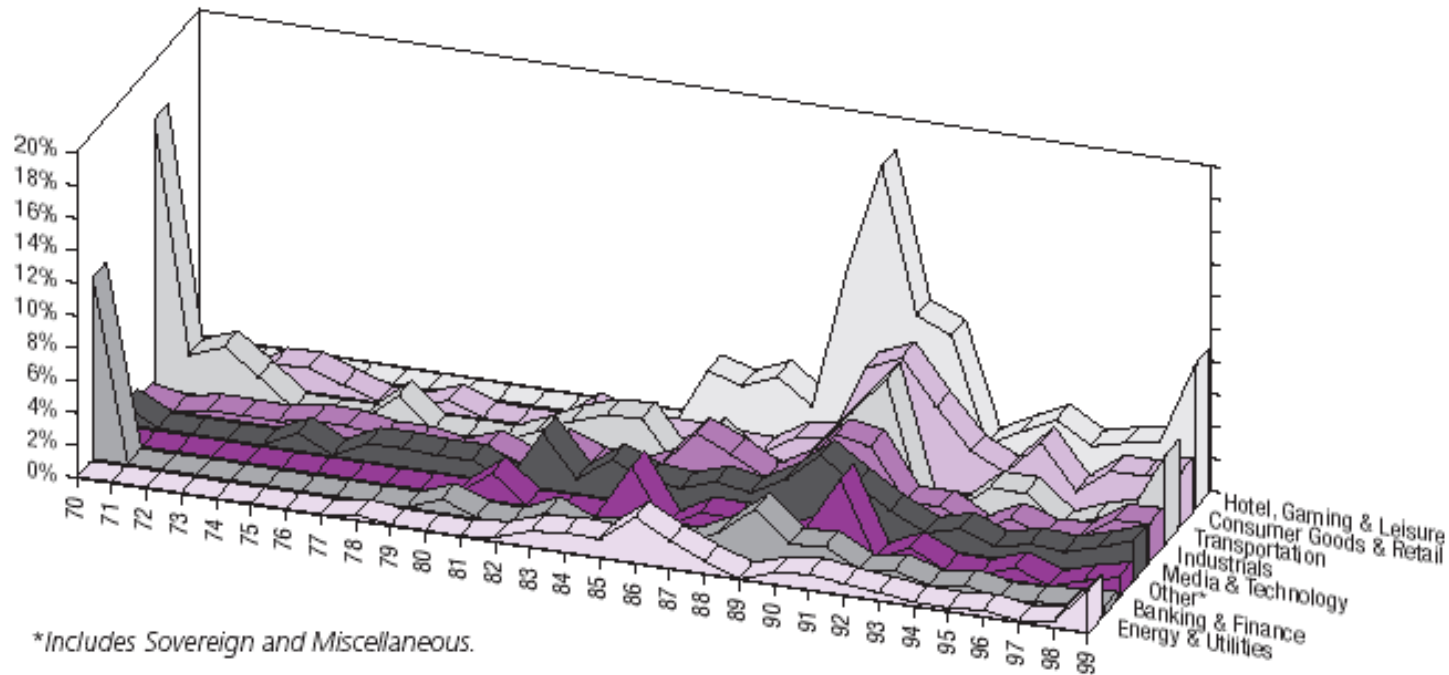
Macro analysis with credit ratings

Percentage external assets in US, 2006 CPIS
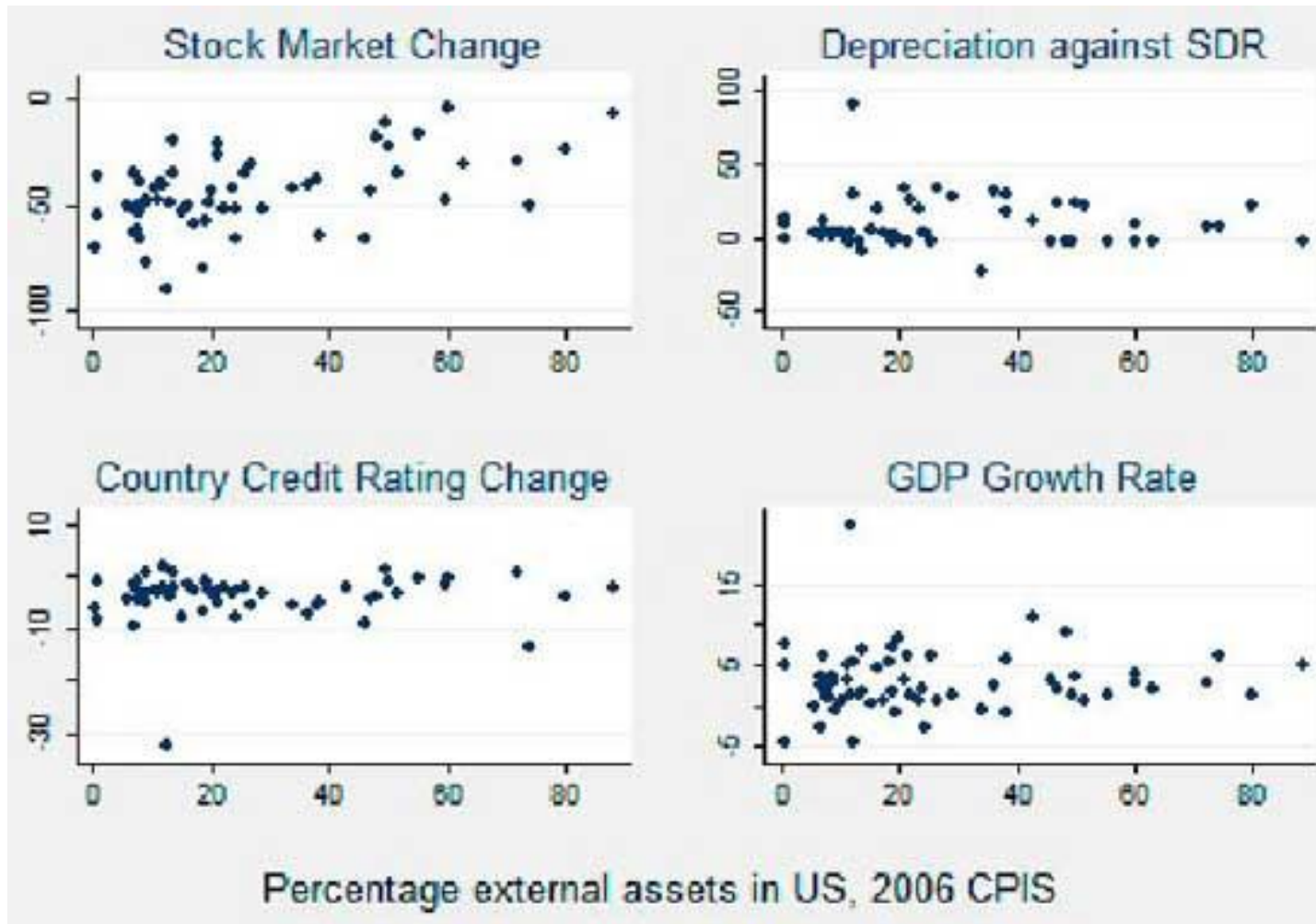
"Searching for International Contagion in the 2008 Financial Crisis", VoxEU.com, October, 2009
By Andrew K. Rose and Mark M. Spiegel

Financial markets standards

Transaction based standards

--- FIX

--- FpML

--- SWIFT

--- ISO 20022

Entity based standards

--- GAAP

--- IFRS

--- XBRL

Congress considers making XBRL the disclosure standard

- Bipartisan legislation, H.R. 2392, to make XBRL the standard for disclosure to the U.S. government has been approved in committee and reported to the full House of Representatives for consideration.

- Rep. Darrell Issa [R-CA 49] lead sponsor