XBRL and Credit ratings
Workshop on Improving Access
Financial Data on the Web
Washington, DC
October 5 - 6th, 2009
Cate Long, 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

Underwriter  

8.70%.

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 *)

<table>
<thead>
<tr>
<th>Moody’s</th>
<th>5 Year Median Default Probability</th>
<th>Tangible Net Worth or Net Asset Percentage</th>
<th>S&amp;P</th>
<th>5 Year Median Default Probability</th>
<th>Tangible Net Worth or Net Asset Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa</td>
<td>0.020%</td>
<td>7.50%</td>
<td>AAA</td>
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<td>B+</td>
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</table>
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 not published list of XBRL tags yet
- Said on August 5\(^{th}\) 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

*Includes Sovereign and Miscellaneous.*
Macro analysis with credit ratings

“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