

Credit risk



What is Credit risk?

- The risk of loss from a counterparty who is unwilling or unable to settle its side of a transaction.
- Bonds: The risk that the issuer of a bond may default on interest and/or principal payments or become bankrupt.
- If either event occurs, the investor stands to lose part or all of the investment.
- Also called default risk.

Credit rating



What is Credit rating?

- A way of quantifying the credit risk of a company.
- Evaluates the ability of a company to repay its debts.
- Measurement of credit worthiness.
- Bonds: A way of measuring the relative risk of default on repayment by an issuer of bonds.
- AAA (triple A) applies to the more credit worthy companies unlikely to default.

Bond Rating Agencies

- Moody's
- Standard & Poor's

Table of rating scales

Moody's	Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca, C
S&P	AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, CC, C, D

Problems with current situation



- Risk-return relationship:
 - High risk companies guarantee high returns to compensate the investor.
- Not comparing like-with-like:
 - Need to compare the returns of companies with similar credit risk.
- Hence it is not prudent to have all the companies compared on one table as each carries a different credit risk.
- Solution:
 - Group companies with similar credit risk together as returns will be comparable.

Institution	Nature of Security	CAR Ratio	Rating
			Moody's
Clientele life*	L	2.44	
1 Life	L		
Absa	L	14.2*	Baa3
Clientele life*	G	2.44	
Assupol	G	1.89	
Discovery*	G	3.8	zaAA3
Old Mutual Wealth Fixed Bond	G	3	zaAAA
Momentum	G	2.8	zaAAA
NEDgroup LIFE*	L	12.5*	zaAA-
Liberty Life	G	2.92	zaAAA

Note:

- Bond ratings provide financial market participants with informed opinions, of a standardised nature, on the likelihood that the bond issues will be serviced in an orderly manner.
- The ratings are as per Moody's.