

Credit Risk 101

Credit Ratings

What are credit ratings?

1 Credit ratings ("CR") are forward-looking opinions on the relative ability of a borrower to repay debt in time.



Is Probability of Default the same as CR?

4 No. CR are ordinal measures that express risk using a relative ranking. PD is a numerical (cardinal) measure.



Why do they matter?

2 The higher the rating, the lower the risk of the borrower defaulting, which translates in lower interest rates (and viceversa).



What if there is no CR assigned?

5 Financial models such as **Altman's Z-score model** can be used to predict PD. Other tools include credit default swaps spreads, or market-implied ratings.



Who assigns them?

3 Credit rating agencies (Moody's, Fitch, S&P) issue credit ratings as standardized, credible measures of credit risk.



Why are CR relevant in TP?

6 Creditworthiness drives arm's length interest rates. It is used in price setting, selection of comparables and for risk adjustments.





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Credit Ratings Scale

Long Term

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

Investment Grade

- Lower risk of default
- Stable, reliable borrowers
- Lower borrowing costs

Speculative Grade

- Higher risk of default
- Riskier or more leveraged borrowers
- Higher yields demanded