

Table 7.7 Ratings uses and desired characteristics.

Rating uses	Useful characteristics of ratings		
	1. Counterparty-risk discrimination	2. Sensitivity to economic cycle	3. Rating stability and far-sightedness
a. Underwriting (loan by loan)	Yes	High	Low
b. Customer relation	Yes	Low	High
c. Commercial policy	Yes	Average	Average
d. Early warning / watch list	Yes	Very high	Null
e. Risk control and reporting	Yes	High	Average
f. Provisioning (current IAS)	Yes, for general provisions	High	Null
g. Provisioning (IAS after G20 recommendations)	Yes, for general provisions and for yearly EL calculation	Average	Average
h. Economic capital	Yes	High	Low
i. Regulatory capital ( <i>Pillar 1</i> )	Yes	Average	Average
j. Capital adequacy ( <i>Pillar 2</i> )	Yes	Low	High

Legend:

1. Counterparty-risk discrimination:	Correctly ranked default rates per class (statically and over time), good granularity of rating scale
2. Sensitivity to economic cycle:	Point in Time ratings, that is to say, depending on the stage of economic and credit cycles
3. Rating stability and far-sightedness:	Through the Cycle ratings, that is to say, independent from the stage of economic and credit cycles, depending only on long term idiosyncratic fundamentals of the borrower
a) Underwriting (loan by loan)	Loan by loan evaluation of credit risk, also functional to loan pricing
b) Customer relationship	Customer relationship management, focused on medium term horizon and on a win-win value creation strategy
c) Commercial policy	Portfolio credit analyses, with profitability objectives typically targeting a 1-year time horizon

Table 7.7 (continued)

d) Early warning / watch list	Daily monitoring of a borrower's conditions aimed at selecting a watch list of cases to focus on and possibly triggering risk-mitigation actions
e) Risk control and reporting	Portfolio views of credit risk
f) Provisioning (current IAS)	Calculation of expected but not materialized losses for 'loans and receivables' and 'hold-to-maturity' portfolios. Portfolio fair value estimations for financial statements integrative reports
g) Provisioning (IAS after G20 recommendations)	Expected loss approach for portfolios subject to amortized cost approach. Portfolio fair value estimations for financial statements integrative reports. Impairments (IASB, 2009).
h) Economic capital	VAR-type calculations for portfolio and its segments for a proactive management of credit risk
i) Regulatory capital (Pillar 1)	Basel II, Pillar 1 regulatory compliant aggregate calculations for credit portfolio and its segments
j) Capital Adequacy (Pillar 2)	Basel II, Pillar 2 regulatory compliant aggregate calculations for credit portfolio and its segments