The Research Centre of the Faculty of Economics
cordially invites you to a research seminar
on Wednesday, 3rd December 2014 at 12 p.m. in room P-109 at the
Faculty of Economics, University of Ljubljana

Author: Igor Masten, PhD, Associate Professor, Faculty of Economics,
University of Ljubljana and Bank of Slovenia

Coauthor: Arjana Brezigar-Masten, Faculty of Mathematics, Natural
Sciences and Information Technology, University of Primorska

Coauthor: Matjaž Volk, Bank of Slovenia

will present the article:
"Discretionary Credit Rating and Bank Stability During a
Financial Crisis"

“In this paper we study the incentives for discretionary credit risk assessment under
current banking regulation. We use the Slovenian data on credit ratings assigned by
banks to their clients and study their reliability as predictors of corporate default to
test whether banks in financial distress systematically underestimate credit risk. Our
results show that predictive accuracy of credit ratings deteriorated during the Great
recession both in absolute terms and relative to the benchmark econometric model
that uses only public available data. Moreover, we show that predictive accuracy
was lowest for domestically owned banks and, within this group, for small banks.
We argue that these banks had the largest incentives to under-value risk because
their portfolios were more exposed to non-performing loans and had limited
possibilities to raise additional capital. Given that credit ratings are closely related to
the rates of loan-loss provisions, our analysis indicates that under-estimation of
credit risk served to inate banks' books. These findings can also rationalise the
results of the comprehensive review of the Slovenian banking system in 2013,
which revealed significant capital shortfalls on average, but also significant differences
in capital shortfalls across groups of banks with different incentives to under-
estimate risk. A number of robustness checks confirm the validity of our
conclusions. Our findings provide a plausible explanation of similar ndings of the
comprehensive review in the Euro area prior to the launch of the Single
Supervisory Mechanism in late 2014.”

You can register for the free seminar by phone (01) 58-92-490, or via e-mail:
research.seminars@ef.uni-lj.si by Tuesday, 2nd December 2014.

We look forward to seeing you!