

# [Risk rating](https://assignbuster.com/risk-rating/)

Risk rating Banking supervision is increasingly important because significant loan losses and bank failures from the 1980s till now.

Financial crisis in recent years, CAMEL is a useful system to examine the safety and soundness of banks. This paper aims to determine whether the CAMEL framework plays a crucial role in banking supervision. the purpose is to identify the benefits as well as drawbacks. This paper also introduces other bank rating system. The paper firstly starts to collect theory relevant to the empirical research, and then draws conclusions from the findings by relating them back to the literature. In developed countries, the regulatory authorities of the rating system as the representative of the United States, only five indicators: capital adequacy, asset quality, management, profitability and liquidity. So just to make up the alphabetical CAMEL, therefore also known as “ camel” rating method (will be described in detail later).

The United States has three worlds leading rating agencies: Standard & Poors, Moodys and Fitch. Because as an independent, not biased in favor of any market participant, not subject to any tendencies, so the results are more neutral, the rating agencies in the market and more widely applied in developed countries. Bank rating index system is divided into seven categories: economic capital, risk sensitivity and risk management, management, profitability, operating values, operating environment, and the ownership and management rights (Morgan, D. P. 2000). The worlds leading rating agencies have established a bank rating model. Moodys were designed for developed markets and developing markets two bank rating methodology.

Although in different markets, the rating analyzed index and related index weights, but the framework of Moodys bank ratings is basically used index composed of seven pillars. Bank Standard & Poors credit analysis model also uses a wide range of quantitative and qualitative analysis, and for different regions and different banking institutions determine the different analytical focus, at the same time, also consider the bank where the specific economic, legal, banking range, accounting system and competitive environment, choose the appropriate analysis of indicators and analysis weights. (Livingston, M., Wei, J. D.

, & Zhou, L. 2010) One is the new “ Basel II” was first proposed to use external ratings to calculate the risk of the banks assets, to further affirm and enhance the importance of the bank ratings. The new agreement will be minimum capital standards, regulatory supervision and market discipline – “ three elements” together, constitute the core principles of the new agreement, with emphasis on risk identification and risk management. The new agreement stated that the banks risk are mainly three types, namely credit risk, market risk and other risks (including interest rate risk, operational risk, legal and reputation risk), where credit risk is the most important financial risks. In order to accurately determine the credit risk of banks, the new capital agreement gives the two alternative ways: First, a higher degree of complexity of the banking business, which can be internal ratings as a basis for determining the risk weight of its credit assets, according to This calculation of capital adequacy ratio. Second, the use of external ratings (such as Standard & Poors and Moodys ratings) to determine the credit risk of the banks risk weight. (Bryman, Alan and Bell, Emma 2003). How do three rating company give rating grade see below table.

Banks occupy a very important position in the social economy, and credit ratings played a supervision, strengthen the role of transparency of information, which greatly promoted the stability of the entire economic environment, risk monitoring and prevention system is an important component. (Barr, Richard S. et al. 2002). Bank™s credit rating helps financial regulators to make timely and effective supervision and management of risk oversight, an important basis for risk control. Banking regulators on ratings only different from commercial banks within the banks self-assessment, but also different from the market rating companys ratings for banks, as the banks three objectives (safety, profitability and liquidity), the different subjects on It has three has a different sort of awareness, but regulations require commercial banks to put safety first. On the one hand, regulators hope the rating process through the system, you can discover the commercial banks are currently facing and the potential risks, timely prevention and timely treatment, to prevent the risk. On the other hand, ratings regulatory authorities have made a considerable degree of authority.

Accurate evaluation and estimation can lead to the correct orientation of social capital that can be in the field at the time of the merger secure access to financial resources for investment, to achieve optimal allocation of resources, and increase the efficiency of financial operations. (Afonso, A. 2003).

Bank Rating potentially facilitate banks to raise capital adequacy ratio, reduce non-performing loans, self consciously to control and manage risks, improve profitability, enhance the management capacity. For the bank deposits, and other financial products as an investment channel for investors, commercial banks ratings will undoubtedly be more rational choice of the investor on the basis of information to grasp. Good rating will help banks to attract foreign financing, and in issuing shares, bonds pay relatively low financing costs. In turn, banks, investors and supervisors by rating increased attention to banks, thus the formation of the power urge banks to maintain a healthy business, forming a virtuous cycle network. (Bernanke, Ben S. 2007) Characteristics of “ Camel” rating system is the individual score and the overall score, qualitative analysis and quantitative analysis, rating-oriented, fully taking into account the complexity and risk level of the bank, is to analyze whether banking operations Based on the analysis of the most effective model for health. Specific content of rating system camel, Indicators and Methods.

Bank credit rating procedures and the lack of scientific standardization. Bank credit rating is not tenure, due to changes in internal and external factors, even in the credit rating of the validity of the original assessment of the level may still be changed up or down, so to use static analysis and dynamic analysis of a combination of methods is a better option, Bank credit rating changes in a timely manner to carry out follow-up monitoring. Western countries rating agencies in the credit ratings of the contract is valid, the rating monitoring system should regularly be rated object of operation, risk profile, credit level tracking and monitoring, including macro-economic cycle, industry rise and fall, the international market, the political environment and other objective factors impact on banks credit rating.  “ Camel” rating method, because of its effectiveness, has been adopted by most countries in the world. Camel rating system facilitates regulatory agencies to fully grasp the risk profile of commercial banks and implementation of similar Bank classification regulation, targets to take measures so that the rational allocation of regulatory resources, improves regulatory efficiency, in order to better analyze and evaluate banks to provide the basis for the risk profile. (A)Capital  Adequacy mainly on the capital adequacy ratio, the ratio of total capital to total assets.

Total capital includes capital base and long-term subordinated debt. Basic capital includes equity capital, surplus and undistributed profits and loan loss reserves. (Barker, David, and Holdsworth, David 1993) (B)The possibility of concentration of loans and lending problems; the number (2) Asset quality (Asset Quality) mainly on risk assets; expected number of loans; adequacy of the allowance for doubtful accounts; quality management personnel. (C)       Asset Quality mainly on risk assets; expected number of loans; the possibility of concentration of loans as well as credit problems; adequacy of the allowance for doubtful accounts; quality management personnel. (Uniform Financial Institutions Rating System, 1997, p.

4). According to Grier (2007), management (Management) mainly on banking policy, business plans, management experience and experience level, training of staff and so on. (D)      Earnings mainly on the bank in the past one or two years of net income situation. Profitability evaluation criteria: the capital gains rate of 1% as a standard, in order to be evaluated.

Changes ROE = Net Earnings / Average assets (Uniform Financial Institutions Rating System 1997, p. 5). (E)       Liquidity case mainly on bank deposits; bank reliance on borrowed funds; the number of flow can readily realizable assets; management of assets and liabilities, the ability to control; frequency and the ability to borrow money quickly to raise funds. Liquidity evaluation criteria: no established standards, only with similar, horizontal comparison with the size of the bank, in order to determine the merits and strength. (Uniform Financial Institutions Rating System 1997, p. 8). Grier (2007) suggests that liquidity is considered to be the single most important element in the CAMEL rating system however, it is subject to measure as the asset quality examination.

(F)       Market risk sensitivity, bank interest rate and exchange rate risk management capabilities resilience, examine its banking assets, the market value of equity, debt and capital and so on. There are two comprehensive evaluation methods: a simple identification, Grier (2007) said averaging the six points above mentioned, resulting in a final grade; the other is weighted found that the above-mentioned six areas were given different weights, weighted average, resulting in a final grade. ;, [-Z]