Working Title: A Comparative Study of Two Different Credit Models

Abstract:

With the new regulatory standards of Basel II the literature regarding credit risk models has grown. However, few empirical comparative studies between different methodologies have been conducted. Two influential methodologies have been RiskMetrics Group's CreditMetrics and McKinsey's CreditPortfolioView. CreditMetrics relies upon two critical assumptions: first, all firms within the same rating class have the same default rate, and second, the actual default rate is equal to the historical average default rate. CreditPortfolioView is a discrete time multi-period model where default probabilities are conditional on the macro-variables such as unemployment, the level of interest rates, and the growth rate in the economy. CreditPortfolioView and CreditMetrics offer two differing opinions regarding the best methodology to estimate transition and default probabilities. Thus, our study compares the estimated transition and default probabilities produced by both models with actual data from a super-regional bank's indirect auto loan portfolio.

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