

**Discussion of:**  
**L. Giaccherini, G. Pepe**  
**“CDO Under Basel II: do ratings  
provide the *right size* for risk?”**

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# Aim of the paper

- Rating agencies into the eye of the storm for assigning the wrong ratings to the tranches of structured products
- Tranche ratings are also the basis for computing capital charges of the tranches held in the banking book (Basel II)
- Are those CC in line with the EC which should be held on those instruments?

# Measures of CC and EC

- CC:
  - ◆ Rating Based Approach - Fitch Vector 3.2
  - ◆ Supervisory Formula Approach
- EC:
  - ◆ Tail measure of loss distribution according to the One factor Gaussian Copula (integrated with a maturity adjustment)

# Contributions of the paper

- Accurate comparison EC-CC for a very popular structured product: scarce literature on the topic
- Nice specification of the model for computing the EC..
- .. innovative measurement of the maturity adjustment

# Suggestions

- UL misleading: Tail-type measure (Expected + Unexpected loss) rather than Unexpected Loss
- Estimate both components of the EC separately:  
Tail measure and Maturity adjustment
  - ◆ More informative
  - ◆ Tail measure can be directly compared with RBA / SFA

# Suggestions

- State the assumptions behind Vector 3.2:
  - ◆ Probabilities of default?
  - ◆ Correlation?
  - ◆ How do they compare with the assumptions you make for the EC model?
- p.3: loss is calculated at 99.9th percentile, while  $x = 0.01$ th percentile
- LHP used for MTM calculation not consistent with the Heterogeneous approach of the tail measure

# Minor Suggestions

- p.3: is the EL formula (3) necessary?
- Flat default intensity assumption: is it realistic over the time period considered?
- Are the CC the same over the two periods?