

Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Kryštof Wolf
Advisor:	PhDr. Jakub Seidler, Ph.D.
Title of the thesis:	What Are the Main Determinants of Banks' Ratings Across CEE Countries?

OVERALL ASSESSMENT *(provided in English, Czech, or Slovak):*

The thesis investigates the impact of different classes of determinants, i.e. bank-specific accounting information and ratios, macroeconomic indicators as well as selected qualitative indicators, on rating awarded by CRAs to banks in the CEE region. The thesis opens with introduction to the topic, history of credit rating and explanation of importance of rating. The author then provides a quite detailed overview of the literature and draws attention to characteristics of the CEE banking sectors. In chapter 4 the methodology most frequently used in the relevant literature, ordered logit models and multiple discriminant analyses, is thoroughly described. In chapter 5, the author elaborates on explanatory variables used in the empirical part and clearly formulates his research questions. According to the author the added value of this thesis is the extension of potential credit rating determinants by qualitative aspects of a banking sector, i.e. bank size, EBRD index as a proxy for a country's institutional environment, market concentration. The empirical part of the thesis, chapter 6, is well described, fulfilment of model assumptions is properly verified and model estimation follows the practice established in the literature. Despite this, there are several points that could be raised:

- The author highlights the issue of „issuer pays“ models in credit rating, where rating agencies are paid by rated subjects, thus to keep their customer base, the agencies are motivated to assign better than true ratings and as such introduce moral hazard problems. The presented models in this thesis do not account for this problem. Thus, how could this issue be incorporated into credit rating determinants analysis? Incorporation of CRA characteristics, e.g. financial situation/profitability or their market share, among RHS variables might mitigate this issue.
- Similarly, the difference between solicited rating (the subject initiates the rating process and provides publicly undisclosed data to CRA) and unsolicited rating (rating is assigned based on publicly available data only) should be acknowledged in the analysis. The author does not elaborate on which type of rating is used in the analysis. The two rating types do not only differ in terms of information quality but solicited rating might be more prone to potential moral hazard problems.
- In chapters 3 and 5, the author accounts for the importance of competition/concentration in credit rating modelling. However, more recent literature (e.g. Claessens and Laeven, 2004) shows that higher concentration does not necessarily imply lower competition and vice versa. Moreover, market structure measures, such as concentration ratio C5 or Herfindahl-Hirschman index, are not good market competition proxies. Therefore, the distinction between these two market features needs to be kept in mind and the relevant passages in the thesis should be adjusted accordingly.
- In line with previous point, formulation of hypothesis no. 7 on page 41 is slightly confusing as it contradicts the discussion on market concentration on the same page. First, the author states that a more concentrated market with higher prices suffers from low competition but allows for higher bank profits and thus stabilizes the financial market. In the hypothesis itself, the author, however, asserts that in more concentrated markets banks need to lower their prices and as such are more likely to face insolvency. Which statement is relevant?
- The author states in chapters 5 and 6 that due to interest in generally valid determinants of rating in this analysis, information about rating agency that assigns the rating is disregarded. Is this approach really appropriate? In case that different rating agencies assign different rating to a subject, how is this treated in the analysis? Again, moral hazard problems would justify the inclusion of CRA information among controls.
- The author justifies the use of data pooling by investigating only generally valid determinants of rating. This, however, ignores the panel structure of the data which could be more beneficial

Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Kryštof Wolf
Advisor:	PhDr. Jakub Seidler, Ph.D.
Title of the thesis:	What Are the Main Determinants of Banks' Ratings Across CEE Countries?

for the analysis (individual bank-level, country-level). Another objection that comes to mind is absence of standard error clustering. The main model, ordered logit model, could have been enhanced by error clustering (on the bank level) which allows for intragroup correlations among standard errors of individual bank observations. Without clustering, estimated standard errors might be too low and consequently increase significance of rating determinants.

- Finally, the author mentions that using single variables instead of factor scores deteriorates the model as the variables turn out insignificant. Why is that?

Overall, the thesis is easy to follow, nicely structured and well written, apart from several typos or reverse word order (e.g. p. 15 „from obvious reasons“, p. 17 „from this reason“, p. 19 „subsidiaries“ instead of subsidiaries, p. 39, equation 5.1 „IM“ instead of IL, p.40 H4 „prevents banks go bankrupt“ or p.46 „signilizing“ instead of signalling). However, due to several issues concerning methodology outlined above I recommend this thesis for defense with the suggested grade “good”. In case of a successful defense of the highlighted issues, the evaluation could be upgraded to “excellent”.

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
<i>Literature</i> (max. 20 points)	20
<i>Methods</i> (max. 30 points)	15
<i>Contribution</i> (max. 30 points)	25
<i>Manuscript Form</i> (max. 20 points)	18
TOTAL POINTS (max. 100 points)	78
GRADE (1 – 2 – 3 – 4)	2

NAME OF THE REFEREE: Mgr. Diana Žigraiová

DATE OF EVALUATION: 15.6.2015



Referee Signature