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Addendum 4 to the CRI *Technical Report, (Version: 2012, Update 2)*[1]

This document updates the *Technical Report (Version: 2012, Update 2)* and details the manner in which companies are treated after a default event. The changes have been implemented as of the calibration available on 4 December.

III. Changes to treatment of companies after a default event

The previous treatment in the CRI system was to discontinue the PD for any company that had experienced any type of default event. In other words, the PD was calculated only to the date when a company first experienced a default event. The underlying assumption was that companies are inactive after any default event. Even if the company resumed operations after the event, the PD was not computed unless there was a manual intervention for special cases.

General Motors is an example of a special case. After GM filed for Chapter 11 reorganization in June 2009, the company resumed operations in March 2011. As of March 2011, after the company resumed operations, we decided to treat GM as a new company. Being treated as a new company implies that the new company's PDs are not affected by the financial statement or market cap data prior to the event. So, the PDs calculated are independent of the PDs that were generated before the default event. On our website, the PDs are however displayed on a single graph for the convenience of our users.

In order to implement the new treatment, default events are now classified into hard defaults and soft defaults. The classification of the types of default are given in the table below.

Hard defaults are default events that are typically permanent. In other words, companies typically cannot emerge from hard defaults. An example of a hard default is a forced liquidation of a company. There will be no difference from previously in the treatment of companies that experience a hard default event; PDs will not be computed after the default event unless there is an exceptional circumstance that warrants a manual intervention (like we did for the GM-case).

Soft defaults are default events that companies can typically emerge from. An example of a soft default is a debt restructuring. These soft defaults are treated differently as of the results released on 4 December. More specifically, after a soft default, if there is sufficient data for the company then the company is assumed to have been able to continue its operations and PDs are computed. The PDs are generated once there is a sufficient history of both the market capitalization data and the new financial statement data (released after the event) is available.

For example, take the Australian company Marion Energy Ltd, which had a debt restructuring in April 2010 and is considered to be a default event under the RMI default

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[1] Compared to a previous version of this addendum, Table 1 has been modified to reflect our current definition of default.

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definition. We have PD until 31 March 2010 and then stop calculating PD. With the new treatment, a debt restructuring is considered to be a soft default and we start calculating PD again as of 30th of September 2010 when the data requirements are met. The company is then treated as a new company which implies that the new company's PDs will not be affected by the financial statement or market data prior to the event. On our website, the PDs will however be displayed on a single graph for the convenience of our users.

Default – Action Type	Subcategory
Hard Defaults (Default events that are typically permanent)	Administration, Arrangement, Canadian CCAA, Chapter7, Chapter11, Chapter15, Conservatorship, Insolvency, Japanese CRL, Judicial Management, Liquidation, Pre-Negotiated Chapter 11, Protection, Receivership, Rehabilitation, Rehabilitation (Thailand 1997), Reorganization, Restructuring, Section 304, Supreme court declaration, Winding Up, Work Out, Other, Unknown
Soft Defaults (Default events that companies can emerge from)	Coupon & Principal Payment, Coupon Payment Only, Debt Restructuring, Interest Payment, Loan Payment, Principal Payment, ADR (Japan only), Declared Sick (India only), Unknown

Table 1: Classification of default events

This change in treatment does not apply to Chinese companies. Similar to previously, Chinese companies are assumed to return from any event of default. We implement this exception for China for two reasons: (1) a firm typically experiences few repercussions from the default and continue operating normally; and (2) it is common for another firm to take over a defaulted firm's listing. This happens due to the limited supply of exchange listings. Both of these situations can be considered as emerging from default, so the CRI system enters all of these companies back into the calibration as new companies.

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