Basel II Advanced IRB in Commercial Banking: Quantify the Borrower and Guarantor by Two-Step Scoring Model

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ABSTRACT

For public companies, the probability of default usually adopts well-known structural and reduced form credit risk models. However, in commercial lending, there are large portfolios of unlisted companies, which could not use these two approaches. Furthermore, privately held companies commonly get a guarantor to enhance their credibility during loan application. Unlike the single logistic model used for retail credit risk analysis, two-step credit scoring models could be used to quantify both borrower and guarantor's risk exposed to unlisted companies based on the limited information maximum likelihood. This paper will focus on how to quantify the risk for commercial borrowers with guaranty by two-step scoring model, which provides Basel II advanced IRB risk measure: the PD for the commercial customer and transaction.

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