Perspective on “Roles of Regional Credit Rating Agencies”

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Outline

1. Revisit of Key Papers
2. ACRAA’s Achievements
3. Challenges and way-forward
1. Revisit of Key Papers

(1) “Development of Regional Standards for Asian Credit Rating Agencies - Issues, Challenges and Strategic Options” by Asian Bankers Association, Oct 2000

- Investors survey revealed that Domestic CRAs:
  - Have better understanding and insights of local companies and better access to local information; but not capitalize this advantage
  - Are poor in timely rating actions and in quality of rating reports and analysts
  - Could enhance their credibility by improving four areas, i.e., (i) independence, (ii) transparency, (iii) accuracy of ratings and (iv) quality of analysis
The paper highlighted “harmonization”

- defined as “convergence of various practices and rating principles across borders”
- viewed as a continuous dynamic process to identify best practices and establish common criteria
- whereby domestic CRAs can improve the quality of analysis and reliability of their rating performance, which will in turn improve their credibility and enhance cross border investment.

Challenges for harmonization in two categories:

(a) **Structural differences** encompassing structure of domestic bond markets, accounting and disclosure standards, legal and regulatory framework, judgmental factors, and sovereign risk

→ *May not be feasible to establish absolute common benchmarks.*

(b) **Internal differences** covering divergence in rating practices and different skills level and experience of domestic CRAs
Establishment of ACRAA in Sep 2001

(Source) ABA’s paper, Oct 2000
Challenges to set up a regional CRA

- The paper illustrates an outline of a regional CRA (R-CRA):
  - R-CRA will rate domestic, regional and int’l bonds
  - R-CRA will be properly incorporated and managed independently
  - R-CRA will develop its own regional rating standards and regional rating scales, for which
    - sovereign ratings will be required
    - dual ratings (domestic and regional) may be assigned
    - serve as an alternative source of credit opinion for global investors
(2) “Development of Regional Standards for Asian Credit Rating Agencies – Progress and Changes” by Asian Development Bank, May 2004

The paper pointed out that:

- Region-wide Asian Bond Market would fuel the demand for regional ratings and the need for cross-border comparability of domestic ratings.

- Domestic CRAs could capitalize these opportunities in view of their in-depth knowledge and appreciation of local environment.

- Domestic CRAs could better serve SMEs and smaller issuers with relatively lower rating fees.
Survey among Domestic CRAs revealed that:

- 80% of Domestic CRAs agree that harmonization would enhance their credibility and help improve rating quality.

- Nonetheless, 2/3 noted the existence of impediments for harmonization in reality.

(Source) ADB's paper, May 2004
Steps toward Regional CRA

- Domestic CRAs to work together to share information and knowledge.
- D-CRAs to establish a common database to consolidate info so that common regional benchmarks will be developed. → ACRAA could work as springboard.
- Regional CRA could occur:
  a) evolution of ACRAA
  b) a body endorsed by ACRAA
  c) bilateral/multilateral arrangements among D-CRAs

(Source) ADB's paper, May 2004
2. ACRAA’s Achievements

- Association of Credit Rating Agencies in Asia (ACRAA)
  - Establishment: September 2001
  - Member CRA: 25 CRAs from 14 countries/economies
  - Board members: Chairman (JCR), Vice Chairman (ICRA), Directors (JCR-VIS, PEFINDO, CRISL), Secretary-General (PhilRating)
- Objectives:
  - To develop and maintain cooperative efforts that promote interaction and exchange of ideas, experiences, information, knowledge and skills among credit rating agencies in Asia and that would enhance their capabilities and their role of providing reliable market information.
  - To undertake activities aimed at promoting the adoption of best practices and common standards that ensure high quality and comparability of credit ratings throughout the region, following the highest norms of ethics and professional conduct.
  - To undertake activities aimed at promoting the development of Asia's bond markets and cross-border investment throughout the region.
BAHRAIN
- Islamic International Rating Agency (IRA)

BANGLADESH
- Credit Rating Agency of Bangladesh Limited (CRAB)
- Credit Rating Information & Services Limited (CRISL)

CHINA
- China Chengxin International Credit rating Co., Ltd. (CCXI)
- Dagong Global Credit Rating Co., Ltd. (Dagong)
- Shanghai Far East Credit Rating Co., Ltd. (SFECR)

INDIA
- Bhoviak Ratings India Pvt. Ltd.
- Credit Analyst and Research Limited (CARE)
- CRISIL Limited
- ICRA Limited

INDONESIA
- PEFINDO Credit Rating Indonesia (PEFINDO)

JAPAN
- Japan Credit Rating Agency Limited (JCR)

KOREA
- Korea Investors Service, Inc. (KIS)
- Korea Ratings Corporation (Korea Ratings)
- NICE investors Service Co., Ltd. (NICE)
- Seoul Credit Rating & Information, Ins. (SCRI)

MALAYSIA
- Malaysian Rating Corporation Berhad (MARC)
- Rating Agency Malaysia Berhad (RAM)

PAKISTAN
- JCR-VIS Credit Rating Co. Limited (JCR-VIS)
- Pakistan Credit Rating Agency Limited (PACRA)

PHILIPPINES
- Philippine Rating Services Corporation (PhilRatings)

SRI LANKA
- RAM Ratings (Lanka) Ltd.

TAIPEI, CHINA
- Taiwan Ratings Corp (TRC)

THAILAND
- TRIS Rating Co. Limited (TRIS)

UZBEKISTAN
- Antar Rating (Antar)

(Source) ACRAA's webpage
<table>
<thead>
<tr>
<th>Country</th>
<th>DCRAs</th>
<th>No. of Employees</th>
<th>No of Corporates rated</th>
<th>Bonds Rated</th>
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<tr>
<td></td>
<td></td>
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<td></td>
<td>No. of Bonds</td>
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<td></td>
<td>Amount</td>
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<td>185</td>
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</table>

(Source) JCR

(2007年度、日本格付研究所調べ)
Training Committee
- Training Workshop
- Criteria Harmonization Workshop
- Bilateral Exchange Program

Best Practices Committee
- Best Practices Dialogue
  → Essential Best Practices & Desirable Best Practices
  → Observance of EBP is encouraged within one year and will be monitored regularly

Regulatory Committee
- Conferences with regulatory authorities
Handbook on International Best Practices in Credit Rating

**Essential Best Practices**
- Pre-Rating Requirements
- Rating Definitions and Recognition of Defaults
- Policies and Processes for Ratings
- Confidentiality Requirements
- Independence and Avoidance of Conflicts of Interests
- Policies for Private, Unsolicited and Unaccepted Ratings
- General Code of Conduct
- Compliance with Policies and Process
- Conducting Outreach
- Relations with Regulator and Other CRAs

**Desirable Best Practices**
- Computation of Default Statistics
- Dedicated Advanced Functional Groups
- DCRAs Engaged in Other Businesses
- Use of Rating Enhancers as Early Warning Indicators
- Publication of Rating Criteria
- Market Feedback before Major Policy Changes
A Three-Year Program for ACRAA – Years 2009 to 2011

- Accelerated build-up of CREDIBILITY of all member CRAs through RATINGS HARMONIZATION
- So that meaningful comparability be achieved

3 clusters of activities

- Joint Training Workshops and bilateral exchange program
- Best Practices Dialogues to promote essential and desirable common best practices
- Cooperation with Regulatory Authorities
3. Challenges and way-forward

- Credit Ratings will play even more important roles as the markets develop
  - Bond market
  - Financial soundness indicators (e.g., deposit taking banks, credit derivatives counterparts)
  - Information disclosure, Financial disciplines (e.g., covenants)
  - Regulatory use (e.g., BIS CAR calculation)
Way-forward:

- Evolution toward Regional Credit Rating Agency?
- Otherwise, dominant US CRAs may prevail?
  - Domestic CRAs will be merged / taken over; or
  - Domestic CRAs will remain in a niche market?
- Could we live without regional CRA?
  - Quality – Local knowledge, local understanding, lack of competition
  - Coverage – smaller entities in relation with fee structure

<table>
<thead>
<tr>
<th></th>
<th>No. of Outstanding Credit Ratings</th>
<th>No. of Credit Analysts (incl. Supervisors)</th>
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<tbody>
<tr>
<td>Moody's</td>
<td>1,112,317</td>
<td>1,250</td>
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<tr>
<td>S&amp;P</td>
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<tr>
<td>Fitch</td>
<td>671,947</td>
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<td>Total</td>
<td>3,123,748</td>
<td>4,420</td>
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(Source) US SEC
How do we proceed to a regional CRA?
- Evolution of ACRAA?
- A body endorsed by ACRAA?
- Bilateral/multilateral arrangements among D-CRAs?

Challenges in setting up a regional CRA
- Market demand & Business model (who to serve?)
  - Local issuers in regional/global market?
  - Regional/global issuers in local markets?
  - Financial and human resources (shareholders?)
  → CRA cannot survive without business.

- Are we really coping with the growing demand by local issuers to go regional / global?
- Meanwhile, there are inherent high entry barriers in credit rating business: track record, reputation, market acceptance
Challenges in setting up a regional CRA (cont.)

- Structural differences in Harmonization
  - Disclosure rules (e.g., coverage, frequency)
  - Accounting standards
  - Legal and regulatory treatment

- Sovereign ratings & Rating scales
  - Dual ratings? On global/regional scale & local scale
  - Credibility = Rating scales backed by default statistics

- Other issues worth exploring:
  - Asia only? What about other emerging countries?
  - Tie-up /Tear-up with US CRAs
  - Regulatory arrangement (NRSRO, ECAI)
Another avenue for the role of Asian CRAs
= Contribution to ASEAN+3 Finance Ministers Process

- Credit Guarantee and Investment Facility (CGIF)
- Regional Surveillance Unit of the Chiang Mai Initiative Multilateralization (CMIM)
Thank you for your attention.
[Reference materials]

Papers referred to in this presentation are all available on the following website:

- "Development of Regional Standards for Asian Credit Rating Agencies - Issues, Challenges and Strategic Options" Asian Bankers Association, Oct 2000
  http://www.ctasc.org.tw/conference/Other%20Papers_files%5CCredit%20Ratings_files%5CCRAstudy.PDF

- "Development of Regional Standards for Asian Credit Rating Agencies - Progress & Changes" Asian Development Bank, May 2004


Other portal websites for references:

- Association of Credit Rating Agencies in Asia (ACRAA)
  http://acraa.com/

- ACRAA member credit rating agencies
  http://acraa.com/acraamembers.asp