

Presentation To IOSCO Standing Committee 6

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Introducing ACRAA

- ACRAA – a decade old association representing the rating agencies in Asia and Middle east
- Member agencies 28, operating in 14 jurisdictions
- Age mix- Newly established and as old as 20 yrs
- Operating in diverse markets at different stages of development

Our Mandate

ACRAA envisaged

- Improving quality standards of ratings by facilitating analyst interaction
- Instituting best practices in member agencies and
- Facilitating development of Asian bond markets and cross border investments in the region

ACRAA's Role

To address core objectives ACRAA undertook

- Training
 - training workshops being conducted regularly twice a year,
 - opening doors of communication between analysts between agencies and from countries at a higher rung of development.

- Handbook of Code of Conduct Fundamentals for DCRAAs
 - Adopts the latest IOSCO code,
 - Provides guidance on its implementation, and
 - Requires annual reporting of member agencies on their level of adoption.

ACRAA's Role Cont....

- Finally default studies conducted by rating agencies are being standardized
- This will serve to draw parallels between agencies and countries through idealized default curves
- In turn facilitating investor confidence and encourage regional fund flows

Profile of ACRAA Members

- Member agencies of ACRAA operate in a regulated set up and are licensed in most if not all jurisdictions
- Absence of structured, complex financial transactions, except on a limited scale in India and Malaysia, have perhaps also contributed to rating agencies in these jurisdictions largely maintaining quality of ratings
- Member agencies generally employ the issuer- pays model

Question of Independence & the Issuer-pays model

Defining independence

- Rating opinions are independent of:
 - conflicts arising from relationships with the ratee, either by way of common shareholders, prior or future employer-employee relationships, or personal relationships;
 - the risk return consideration inherent in any transaction. Ratings are purely based on risk considerations;
 - the fee that is paid to the rating agency.

Barriers Against Conflicts

- The decision is taken by the rating committee which is not represented by any financial stakeholders in the rating agency. This is required by the IOSCO and the ACRAA code and is a very fundamental pillar in any rating agency
- The remuneration of analysts and rating committee members is not tied to number of clients they handle. Analysts are not impacted by their rating related views & decisions
- Specific guidelines have been laid down for exclusion of analysts who have had recent employment related or personal relationships with key persons of the rated entity

Local regulators also require some of the above and the ACRAA code of conduct requires its members to report on these annually

Proposed Barriers against Conflicts

Way ahead.....

- ACRAA members may also prohibit analysts from negotiating prospective employment with a ratee while surveillance is underway, requiring a cooling off period
- A team of analysts comprising at least two members could be deployed for every client and the rating committee should also comprise members who do not interact with ratees directly
- Investors will directly benefit from comprehensive reports being available gratis on request if not on website, which detail rating rationales and provide other financial and business information
- Investor contact setups may be established in larger rating agencies

If the above are adopted in spirit, the issuer-pays conflict will become less significant if not entirely eliminated

Ensuring Quality of Ratings

Basic Ingredients

- Availability of qualified staff
- Necessary training and experience and
- Adequate staff strength.

Discussion papers published by ACRAA

- Credit Ratings – The Basics revisited
- Definition of Default
- Conflicts of Interest for CRAs
- Rating Shopping – Why & How to Minimize
- Unsolicited Ratings – A holistic perspective

ACRAA's Response

- For improvement and refinement in QUALITY of methodologies, discussion papers pertaining to the most important rating topics were published to offer guidance to member agencies
- Training workshops
- A blog, the very first of its kind, will be set up to allow analyst level interaction between agencies
- The ACRAA code of conduct requires dedicated staff for rating audit and compliance divisions, research, and separate team for cultivating market outreach

Challenges to Ratings Quality

- Rating Shopping - Specific clauses are needed in regulatory codes that respond to rating shopping
- Requiring ratees to continue with the original rating agency for an extended period in parallel with the new assessment
- Requiring minimum two ratings for large sized transactions or entities whose failure can cause systemic crisis, and
- Requiring all rating agencies to make their assessed ratings public if one makes a public announcement

Challenges to Ratings Quality

Fee Shopping and Rising Competition

- The drive to increase ratings competition has resulted in rating agencies dropping their standards and rating inflation being witnessed over time
- Fee shopping also poses risks in some markets, where too many players have resulted in insufficient revenues to sustain high quality staff and ancillary undertakings like research
- ACRAA supports Rating Fee being transparent with fixed and publicly disclosed schedules for each agency

Quality of Ratings Test

The final test of the quality of ratings is

- the depth and accuracy of analysis in reports
- historical default rates
 - An objective analysis is required to assess whether higher defaults are necessarily attributable to quality/negligence of the rating agency or factors beyond the scope of analysis;
 - Ratings have and will continue to serve markets well as they provide information to investors and their ability to predict creditworthiness across normal business cycles

Cross Border Investment

- The latest endeavor of ACRAA is to facilitate the development of the idealized default curve for member countries
- Drawing parallels between ratings of different agencies and even different countries and what these ratings indicate will be easier and more meaningful with the help of these default curves
- This will provide benchmarks for QUALITY and promote TRANSPARENCY
- It is hoped that this will facilitate confidence in investors to enable cross border investments and facilitate ADB's endeavors under Credit Guarantee and Investment Facility (CGIF)

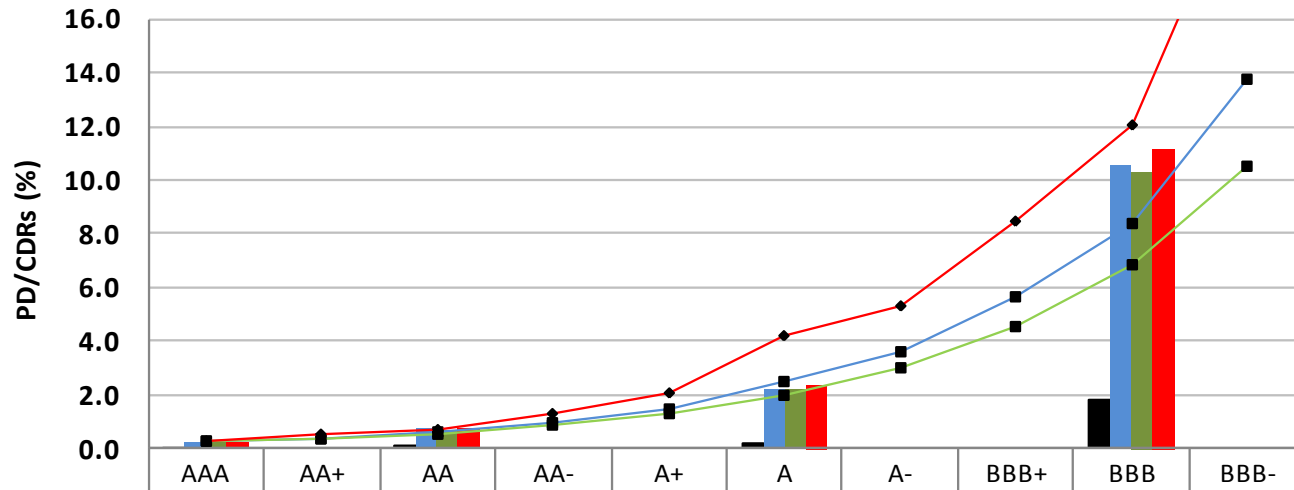
Process of Developing Idealized Default Curve for a Country

1. Highest international CDR/PD multiples for each category taken as benchmarks
2. Average CDR/PD (investment grades) for the country is estimated
3. International benchmark CDR/PD multiples are adjusted to Country's average CDR/PD (investment grades) to get Country's benchmark default rates
4. Estimated CDR/PD curve of the Country is plotted against the above Country's benchmark default rates

Idealized Default Curves for 3 Hypothetical Countries

Based on 3-years CDRs

	International Multiples (%)
AAA	0.06
AA	0.17
A	0.56
BBB	2.63
	Avg. Investment Grade CDRs (%)
Country A	4.0
Country B	3.9
Country C	4.1



	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-
International PDs (Maximum)	0.03		0.09			0.22			1.79	
Country A's Benchmark Default Rates	0.22		0.69			2.22			10.52	
Country B's Benchmark Default Rates	0.22		0.67			2.17			10.26	
Country C's Benchmark Default Rates	0.24		0.74			2.36			11.18	
Country A's Estimated CDRs	0.24	0.38	0.60	0.94	1.47	2.48	3.60	5.63	8.40	13.75
Country B's Estimated CDRs	0.24	0.37	0.55	0.85	1.29	2.00	2.97	4.52	6.80	10.46
Country C's Estimated CDRs	0.30	0.49	0.72	1.27	2.05	4.20	5.29	8.50	12.00	21.95

- International PDs (Maximum)
- Country A's Benchmark Default Rates
- Country B's Benchmark Default Rates
- Country C's Benchmark Default Rates
- Country A's Estimated CDRs
- Country B's Estimated CDRs
- Country C's Estimated CDRs