



# Promoting Rating Culture in OIC Countries: Lessons Learnt from Emerging Markets

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# History of Credit Ratings

- Long before the end of the 19th century, Rating Agencies were set up as Independent Third Parties with the Objective of Protecting Investors' Interest
  - 1860s                      Standard & Poor's (S&P)
  - early 1900s              Moody's
  - 1913                        Fitch
  - 1930s                      Duff & Phelps (DCR)



# Recognition to GCRAAs

- Recognition designated by Securities & Exchange Commission, USA:  
Nationally Recognized Statistical Rating Organizations  
(NRSROs)
- As of November 2011, 9 organizations designated as NRSROs, with the ratings by NRSROs used for a variety of regulatory purposes in the United States
- Single most important factor in the Commission staff's assessment of NRSRO status: whether the rating agency is "nationally recognized" in the United States as an issuer of credible and reliable ratings by the predominant users of securities ratings



Some analysts argue that by recognizing certain GCRAAs as NRSROs, the SEC has bestowed a competitive advantage on them since their ratings are widely accepted

# GCRAs

- Globalization of the financial markets served to expand the role of credit ratings to countries other than the United States, where the reliance on credit ratings largely was confined for the first half of the twentieth century
- 1997 – Fitch merged with IBCA Limited – another NRSRO (limited) headquartered in London and became owned by a French holding company, giving investors an alternative global, full service rating agency capable of competing with S&P and Moody's
- However, power base continued to be largely centralized in the U.S., with both S&P and Moody's being based there and recognized as NRSROs



# GCRAs

In a recent study, while the European Commission concluded that the CRA market is too concentrated and more diversity would be positive, the cost of setting up a new independent European CRA was estimated at as much as Euro 300-500 millions and not considered feasible!



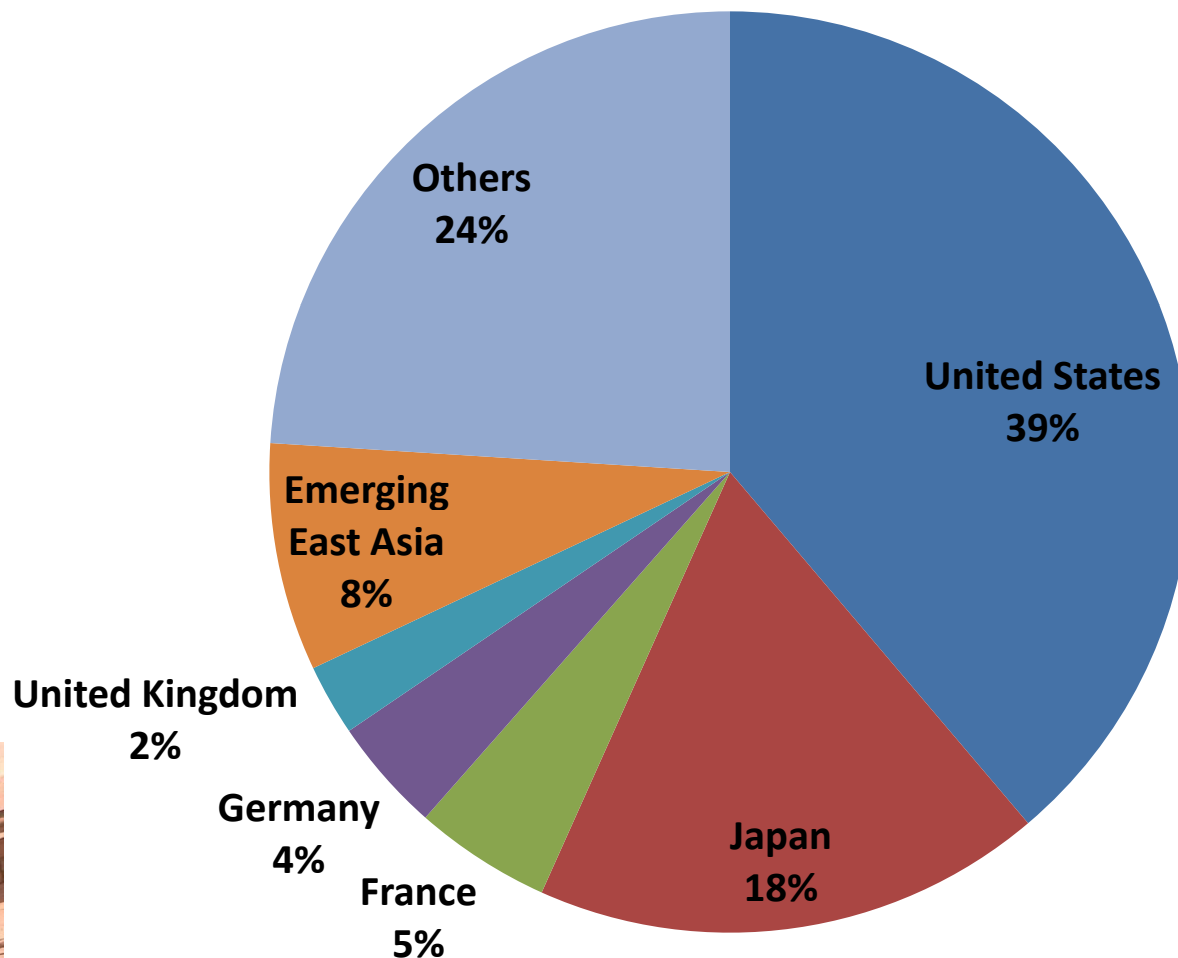
# Use of Ratings

The importance of credit ratings to investors and other market participants has increased significantly, impacting:

- an issuer's access to and cost of capital
- structure of financial transactions, and
- the ability of fiduciaries and others to make particular investments



# World LCY Bond Market



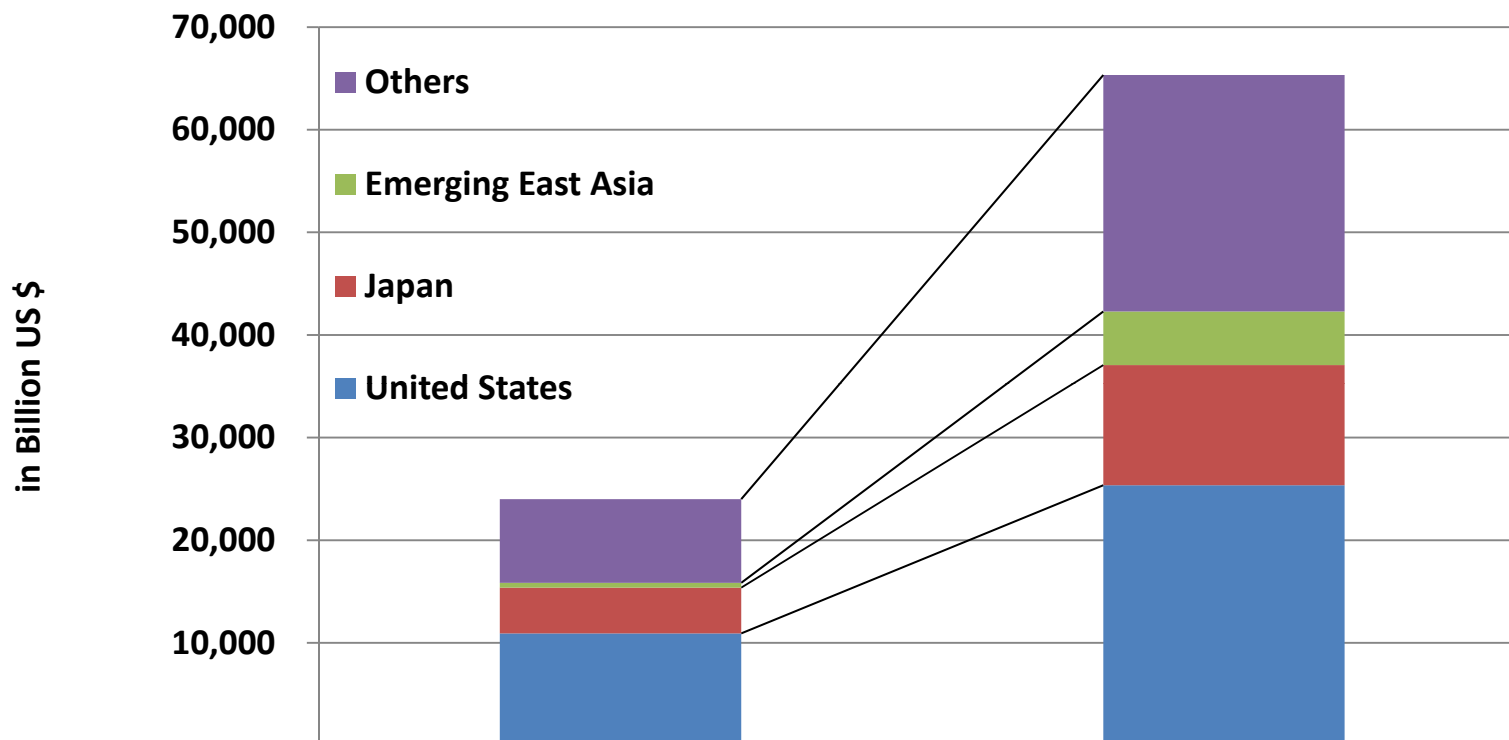
Source: Asia Bond Monitor

LCY: Local Currency

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# World Local Currency Bond Market



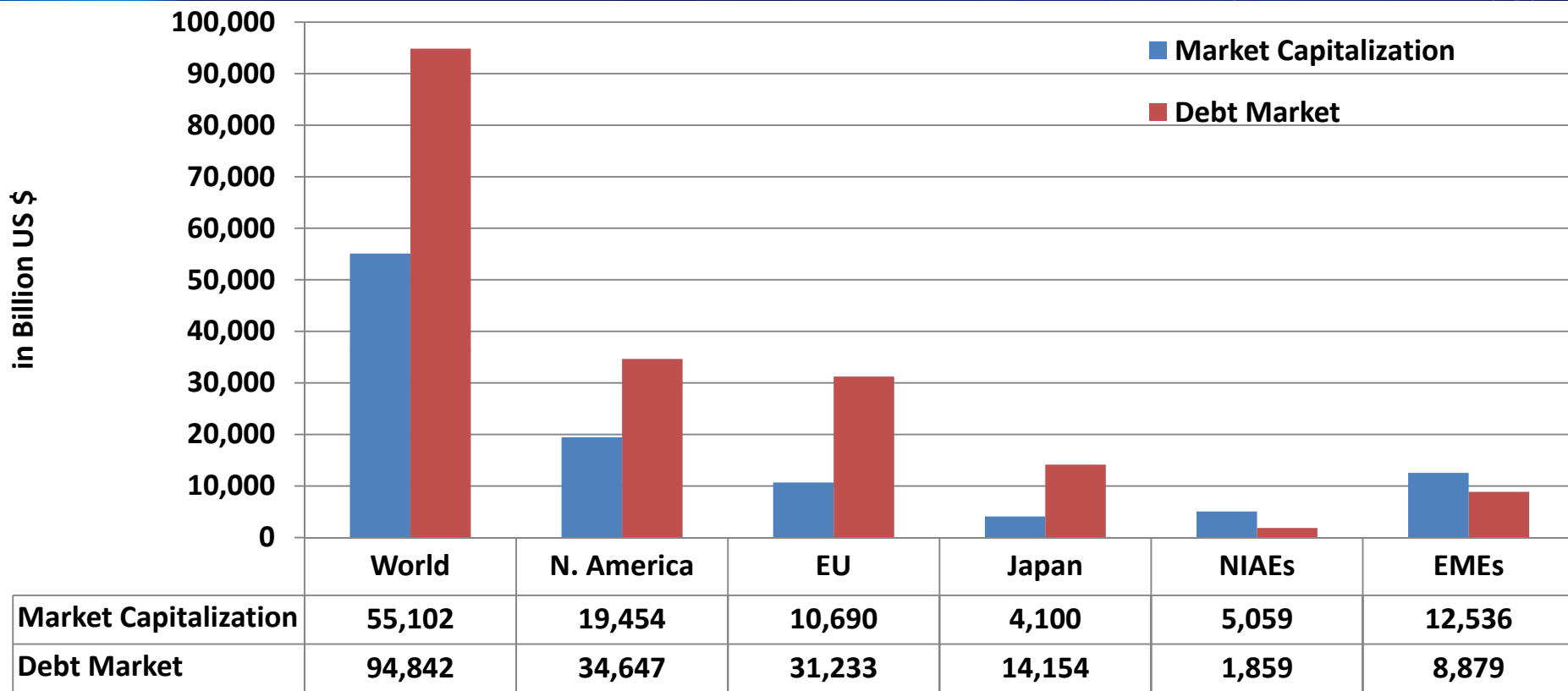
	1996	2010
Others	8,149	23,050
Emerging East Asia	469	5,210
Japan	4,456	11,723
United States	10,926	25,349

World Bond Market (Source: Asia Bond Monitor)

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# Market Capitalization vs. Debt Market



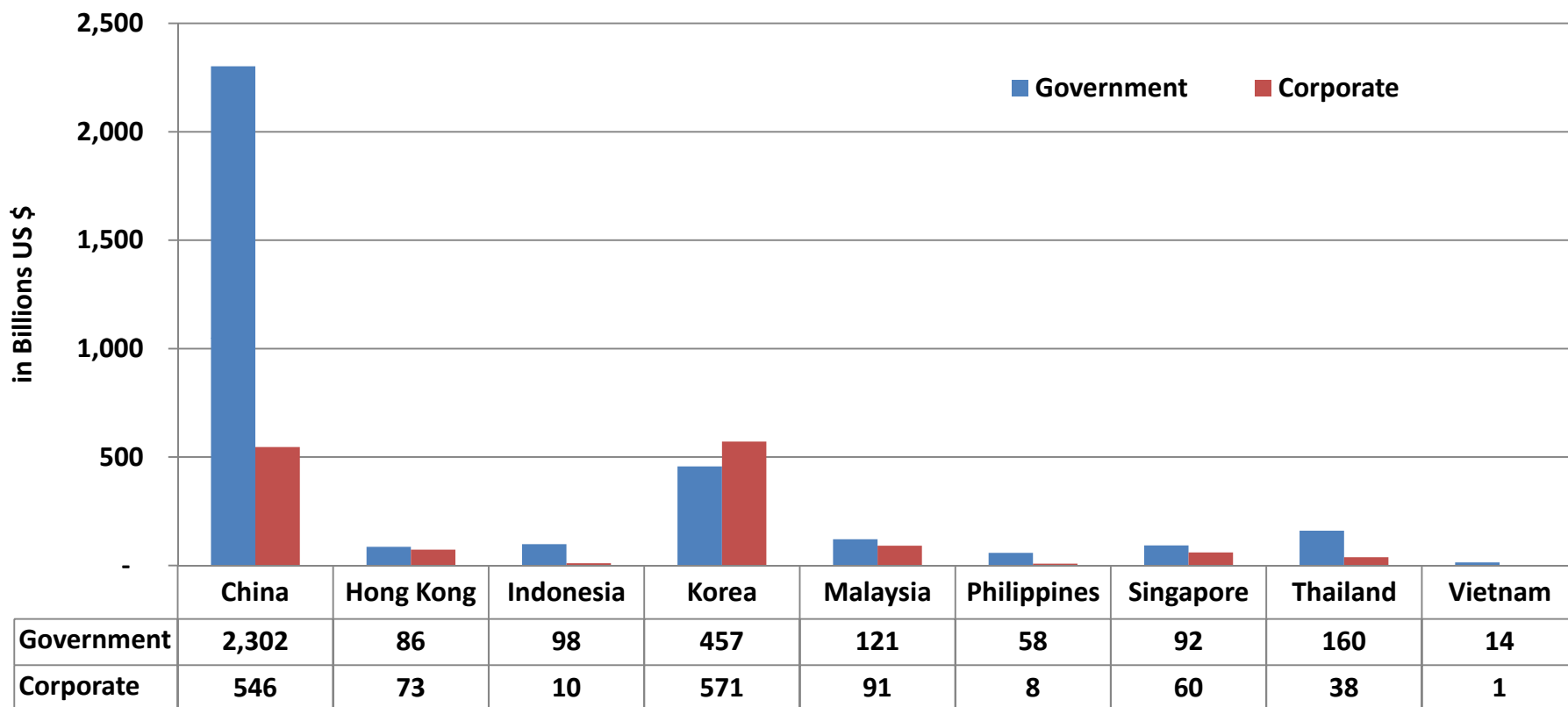
Source: IMF

NIAEs: Newly Industrialized Asian Economies

EMEs: Emerging Market Economies



# Emerging East Asia Bond Market



Emerging East Asia Bond Market (Source: Asia Bond Monitor)



# Role of Regulators

## INDIA

- Six CRAs operational
- Rating paradigm spread from IPOs to bank loan ratings
- Volume of ratings touching almost 25,000
- Contributed to improved credit assessment in the market.
- Net non-performing loans (NPLs) in India have stabilized around 1% in 2007 – 2010 period



# Role of Regulators

## BANGLADESH

- Rating licensing introduced in 2002
- Given the favorable enabling environment, the number of rating outstanding ratings have reached 3,000
- Impact of the well-assessed credit environment again reflected in the trend of NPLs where the net NPLs ratio has shown a marked improvement from 5.17% to 1.28%



# Role of Regulators

What needs to be done to promote the development of capital markets within the region?

- Credit rating agencies have become an important part of modern capital markets; benefits of ratings include:
  - Benchmark for credit pricing
  - Address Gharar – enhance transparency and efficiency in debt capital markets by reducing the information asymmetry between borrowers and lenders
  - Facilitate access to long term capital
  - Reduce dependence on bank credit



Creating a ratings culture

- Short term: regulatory driven
- Long term: market driven

# Role of Regulators

- Development of efficient bond markets is first a function of maturity of capital markets, size and depth of the economy and availability of the necessary regulatory and legal infrastructure. In the absence of these, the role of ratings alone becomes severely limited

What needs to be done?

- Create enabling environment for issuance of bonds
- Tax incentives may need to be provided
- Primary/secondary market infrastructure needs to be developed
- Information dissemination channels to be developed



# Role of Regulators

Regulatory coverage of ratings should include

- All commercial banks, insurance and non banking financial companies
- All areas where public money is directly or indirectly accessed for business i.e debt in any nature
- All listed companies having leverage or debt levels above a certain threshold
- All bank loans above a certain quantum, be they good credits or bad
  - Not imposing a minimum level can lead to cherry picking which skews capital requirements



# Lessons Learned from the Developed World

- The recent global crisis has led to consternation of regulators and investors alike on the role of CRAs among other things. The central bank can address many of these issues upfront by writing detailed regulations for CRAs
- What emerges from a spate of regulatory initiatives are requirements such as:
  - Increased transparency in the rating process
  - Thorough and detailed analysis conducted by superior quality analysts
  - Management and reporting of any conflicts of interest
  - Absolute independence of rating agencies
  - Increased reporting requirements and more stringent regulatory supervision





**Thank You**  
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