



Recent International Regulatory Developments in Credit Rating Agencies

ASEAN+3 ABMI WG4 (Rating Systems)

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Table of Contents

I.	Financial Reporting Supply Chain	P3
II.	Important Issues relating to CRAs	P4
III.	Recent International Regulatory Developments	P5
	1. IOSCO	P6
	2. Basel Committee on Banking Supervision	P11
	3. U.S. SEC	P12
	4. EU	P15

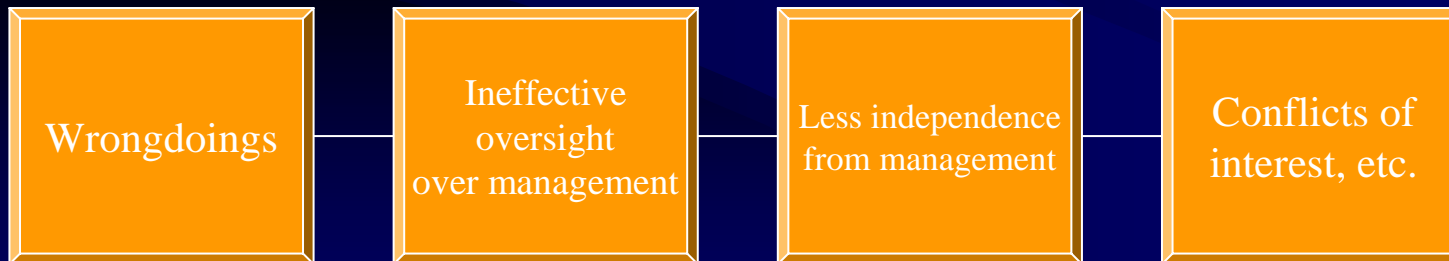


I. Financial Reporting Supply Chain

1. Structure of Chain



2. Problems (Pointed out)



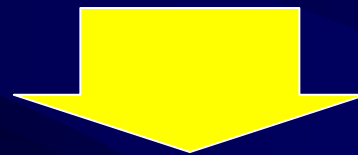


II. Important Issues relating to CRAs

Transparency

Independence and avoidance of conflicts of interest

Competition



Need for a globally harmonized approach on the treatment of CRAs



III . Recent International Regulatory Developments

IOSCO

Basel Committee on Banking Supervision

U.S. SEC

EU



III . Recent International Regulatory Developments

1. IOSCO (1)

(1) IOSCO Statement of Principles Regarding the Activities of CRAs (September 25, 2003)

[Basic Purposes]

- Useful tool for securities regulators, ratings agencies and others wishing to improve how CRAs operate and how the opinions CRAs assign are used by market participants
- The manner in which these Principles are given effect will depend upon local market circumstances and each jurisdiction's legal system.
- Mechanism for implementing the principles may take the form of any combination of government regulations, regulations imposed by non-government statutory regulators, industry codes, and internal rating agency policies and procedures.



III . Recent International Regulatory Developments

1. IOSCO (2)

[Principles]

① Quality and Integrity of the Rating Process

- CRAs should endeavor to issue opinions that help reduce the asymmetry of information among borrowers, lenders and other market participants. [5 Principles]

② Independence and Conflicts of Interest

- CRA ratings decisions should be independent and free from political or economic pressures and from conflicts of interest arising due to the CRA's ownership structure, business or financial activities, or the financial interests of the CRA's employees. CRAs should, as far as possible, avoid activities, procedures or relationships that may compromise or appear to compromise the independence and objectivity of the credit rating operations. [6 Principles]

③ Transparency and Timeliness of Ratings Disclosure

- CRAs should make disclosure and transparency an objective in their ratings activities. [5 Principles]

④ Confidential Information

- CRAs should maintain in confidence all non-public information communicated to them by any issuer, or its agents, under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. [2 Principles]



III . Recent International Regulatory Developments

1. IOSCO (3)

(2) Report on the Activities of CRAs (September 25, 2003)

- Role of CRAs
- Overview of CRA Questionnaire and Questionnaire Responses
- Overview of Key Issues for Securities Regulators
- The Technical Committee's Statement of Principles regarding the Activities of CRAs



III . Recent International Regulatory Developments

1. IOSCO (4)

(3) Code of Conduct Fundamentals for CRAs (December 23, 2004)

[Basic Framework of the Code Fundamentals]

- A set of robust, practical measures that serve as a guide to and a framework for implementing the Principles' objectives
- Fundamentals which should be included in individual CRA code of conduct
- Not designed to be rigid or formulaic and offering CRAs a degree of flexibility in how these measures are incorporated into the individual CRA code of conduct
- Requiring CRAs to disclose how each provision of the Code Fundamentals is addressed in the CRA's own code of conduct



III . Recent International Regulatory Developments

1. IOSCO (5)

[52 concrete measures in the Code Fundamentals]

① Quality and Integrity of the Rating Process [16 measures]

- A. Quality of the Rating Process [8]
- B. Monitoring and Updating [2]
- C. Integrity of the Rating Process [6]

② CRA Independence and Avoidance of Conflicts of Interest [16 measures]

- A. General [5]
- B. CRA Procedures and Policies [5]
- C. CRA Analyst and Employee Independence [6]

③ CRA Responsibilities to the Investing Public and Issuers [18 measures]

- A. Transparency and Timeliness of Rating Disclosure [10]
- B. Treatment of Confidential Information [8]

④ Disclosure of the Code of Conduct and Communication with Market Participants [2 measures]



III . Recent International Regulatory Developments

2. Basel II (1)

(1) Basel II (June 26, 2004)

- **The Standardized Approach measures credit risk, supported by external credit assessments.**
- **National supervisors are responsible for determining an eligible external credits assessment institution (ECAI).**
- **Eligibility Criteria**
 - ① Objectivity
 - ② Independence
 - ③ International access / Transparency
 - ④ Disclosure
 - ⑤ Resources
 - ⑥ Credibility



III . Recent International Regulatory Developments

2. Basel II (2)

(2) Developments in the EU

● CEBS (Committee of European Banking Supervisors)

- Work program for 2005 includes convergence of supervisory practices including recognition process for ECAI.

● UK FSA's Consultative Paper (January 2005)

- Combination of direct and indirect recognition
- Recognition on a group-wide basis
- ECAIs should approach the UK FSA directly for recognition.
- Need to seek separate recognition for different product segments (public finances, corporates, bank and investment firms, insurance companies, and structured finance (including securitization))
- Need only to make a single submission covering their application for recognition in various different product segments
- Undertaking shadow ECAI recognition and mapping processes and producing a shadow list of recognized ECAIs by June 2006
- Requiring approximately nine months to undertake shadow recognition and mapping processes
- Application for formal recognition at the end of 2006
- Requiring recognized ECAIs to undertake “back-testing” of their ratings on an annual basis



III . Recent International Regulatory Developments

3. U.S. SEC (1)

(1) U.S. SEC Concept Release (June 4, 2003)

- ① Alternatives to the NRSRO (Nationally Recognized Statistical Rating Organizations) Designation
- ② Recognition Criteria
- ③ Examination and Oversight of NRSROs
- ④ Conflicts of Interest
- ⑤ Alleged Anticompetitive, Abusive, and Unfair Practices
- ⑥ Information Flow



III . Recent International Regulatory Developments

3. U.S. SEC (2)

(2) U.S. SEC Proposed Rule on Definition of a Nationally Recognized Statistical Rating Organization (“NRSRO”)

Three components in the proposed definition of the term NRSRO

- ① an entity that issues publicly available credit ratings that are current assessments of the creditworthiness of obligators with respect to specific securities or money market instruments;
- ② is generally accepted in the financial markets as an issuer of credible and reliable ratings, including rating for a particular industry or geographic segment, by the predominant users of securities ratings;
- ③ uses systematic procedures designed to ensure credible and reliable ratings, manage potential conflicts of interest, and prevent the misuse of non-public information, and has sufficient financial resources to ensure compliance with those procedures.



III . Recent International Regulatory Developments

3. U.S. SEC (3)

(3) U.S. SEC's authority over NRSROs

(Quoting from the testimony of Director Annette L. Nazareth on April 12, 2005)

- The SEC staff has worked with the current NRSROs during the past six months to craft a framework for voluntary oversight by the SEC.
- The SEC believes that to conduct a rigorous program of NRSRO oversight, more explicit regulatory authority from Congress is necessary.



III . Recent International Regulatory Developments

4. EU (1)

(1) Resolutions

- **Resolution by the European Parliament on the role and methods of rating agencies (February 2004)**

- Calling on the EC (European Commission) to submit by 31 July 2005 its assessment of the need for appropriate legislative proposals

- **Resolution by the German Federal Parliament on improving the integrity, independence and transparency of rating agencies through a code of conduct (March 2004)**

(2) **EC's call to the CESR for technical advice on possible measures concerning CRAs by April 1, 2005**

- Interests and conflicts of interest for CRAs
- Fair presentation of credit ratings
- Relationship between issuers and rating agencies
- Possible entry barriers to the market for the provision of credit ratings
- Use of ratings in European legislation and in private contracts
- Registration



III . Recent International Regulatory Developments

4. EU (2)

(3) CESR's technical advice to the EC on possible measures concerning CRAs (March 30, 2005)

① Four regulatory options

Option A : Monitoring market developments

Options B : Third party certification or enforcement of the IOSCO Code

Option C : Registration / regulation regime “strong” and “light”

- Recognition that a CRA complies with a pre-determined set of criteria established and published by EU authorities
- Authorization to operate in the EU market for the provision of ratings

Option D : Including the IOSCO Code within the CRD's (Capital Requirements Directive) recognition procedure



III . Recent International Regulatory Developments

4. EU (3)

② Issue

The main question for the EU is to what extent the IOSCO Code should be enforced by some regulation mechanism or whether to wait for the CRAs to take sufficient steps to comply with the Code on their own.

③ CCSR favors self-regulation of CRAs established around the IOSCO Code

- A clear majority of CCSR members supports a “wait and see” approach, where no recognition system is set up at present. Should self-regulation fail to occur, there might be a need for statutory regulation.
- A distinct minority of CCSR members supports a recognition system set up for the EU; a system where CRAs voluntarily register and thereby subscribe that they will follow the IOSCO Code.



III . Recent International Regulatory Developments

4. EU (4)

(4) Speech of EC Commissioner McCreevy (April 5, 2005)

- Regulation is not at this time appropriate.
- While we may well conclude that a voluntary code of conduct will suffice for the moment, we will keep the matter under continual review.
- The importance of the agencies' role is enhanced by the provisions of Basel 2.