

# **The FSB's Principles for Reducing Reliance on CRA Ratings**

**Michael W Taylor  
Financial Stability Board  
Brussels, 16 March 2012**

# What is the FSB?

---

- International body established to address financial system vulnerabilities and to coordinate the development and implementation of strong regulatory, supervisory and other policies in the interest of financial stability
- FSF initiated in 1999 by G7 following the Asian crisis
- FSB re-launched by G20 Leaders in April 2009 as a successor to the FSF, with
  - expanded membership
  - broader mandate
  - enhanced operating structure
- FSB Charter adopted by G20 Leaders in September 2009
- Chaired by Mark Carney (Governor of the Bank of Canada), with Secretariat in Basel hosted by the BIS

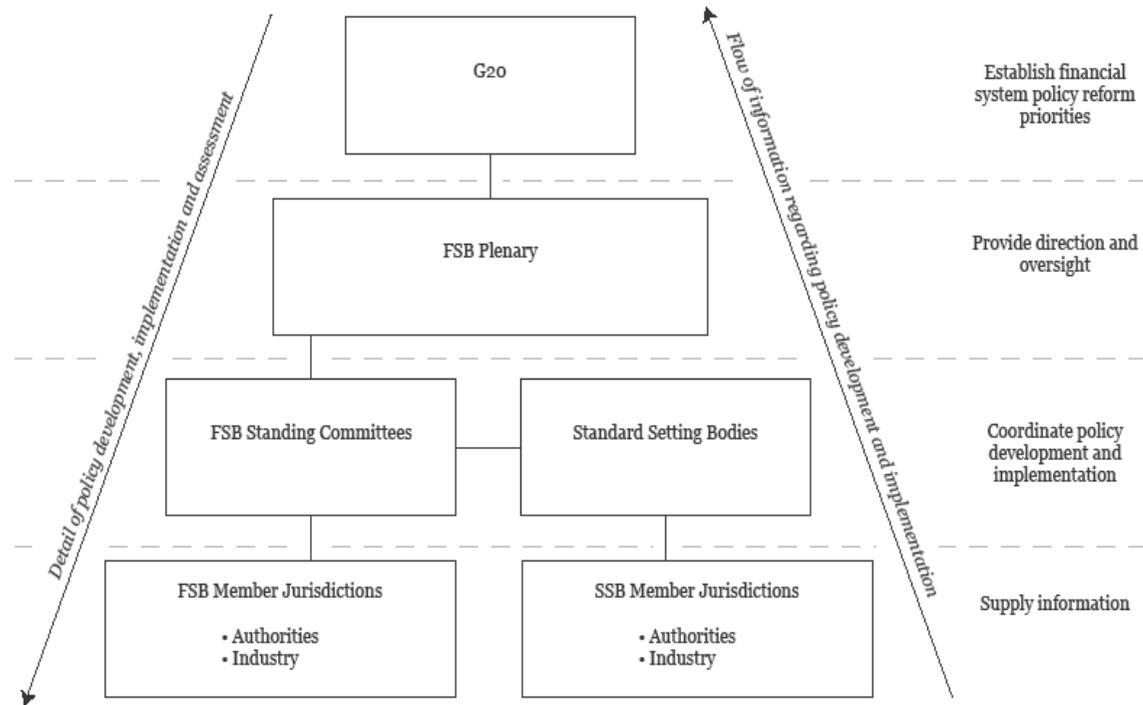
- Vulnerabilities assessment
  - Assess vulnerabilities affecting the financial system and identify and oversee the actions needed to address them
- Supervisory coordination
  - Coordinate work of SSBs, supervisory colleges, resolution planning
- Implementation monitoring
  - Report on implementation of G20 Reform agenda

# Membership

---

- Representation at senior level of:
  - National financial authorities
    - Ministries of finance
    - Central banks
    - Supervisory and regulatory authorities
  - International regulatory and supervisory groups
  - Committees of central banks
  - International financial institutions

# Organisation



# FSB Principles: Objectives

---

- Issued in October 2010; working party chaired by Paul Tucker (BoE)
  - Aim to return CRA ratings to their roots: expression of opinion of creditworthiness, without any implicit or explicit official status
  - Investors and other market participants need to take responsibility for their own decisions
  - Over-reliance on credit ratings, particularly for structured products, led to build-up of exposures in instruments that too many investors did not truly understand
- Herding and cliff effects

# Principles and CRA reform

---

- Steps taken to improve the governance and oversight of CRAs and to encourage better due diligence by investors
- But financial authorities have encouraged over-reliance on CRAs through building ratings into regulatory regimes over the past decade or so
- CRA ratings embedded in numerous regulations: diluted incentives for investors to form their own opinions

# Remove “hard-wiring” of ratings

---

- Official sector should remove or replace references to CRA ratings in rules and regulations wherever possible
- Five areas covered:
  - prudential supervision of banks
  - policies of investment managers and institutional investors about use of ratings; central bank operations
  - private sector collateral agreements
  - disclosures by issuers of securities

# Reducing “mechanistic” reliance

- 
- **Not about abolishing CRA ratings or their use by banks and other investors**
  - **Not about creating official sector ratings to replace them**
  - **Are about finding other ways of incorporating credit risk in capital and other regulatory regimes**
  - **Are about up-grading internal credit assessment processes**
  - **Discourage mechanical or blind reliance on ratings**

# Implications

---

- Market participants will have to upgrade their risk management processes
- Supervisors and regulators will need to satisfy themselves that those improvements in risk management have been made

# Implementation Monitoring

- 
- FSB completed monitoring exercise in February 2012
  - Findings:
    - A few jurisdictions have passed/proposed wide-ranging legislative or regulatory measures to reduce reliance on CRA ratings, but are facing difficulties in detailed implementation
    - International standard setters have examined references to CRA ratings in their standards and, in some cases, have taken steps to disincentivise reliance on CRA ratings. In a number of cases, study of the issue is either ongoing or is only just getting under way
  - Going forward, clear milestones need to be set to reduce reliance on CRA ratings in the medium term
  - FSB will continue to monitor implementation and encourage wider adoption of the Principles



# FSB website

---

<http://www.financialstabilityboard.org>