

The FSB's Principles for Reducing Reliance on CRA Ratings

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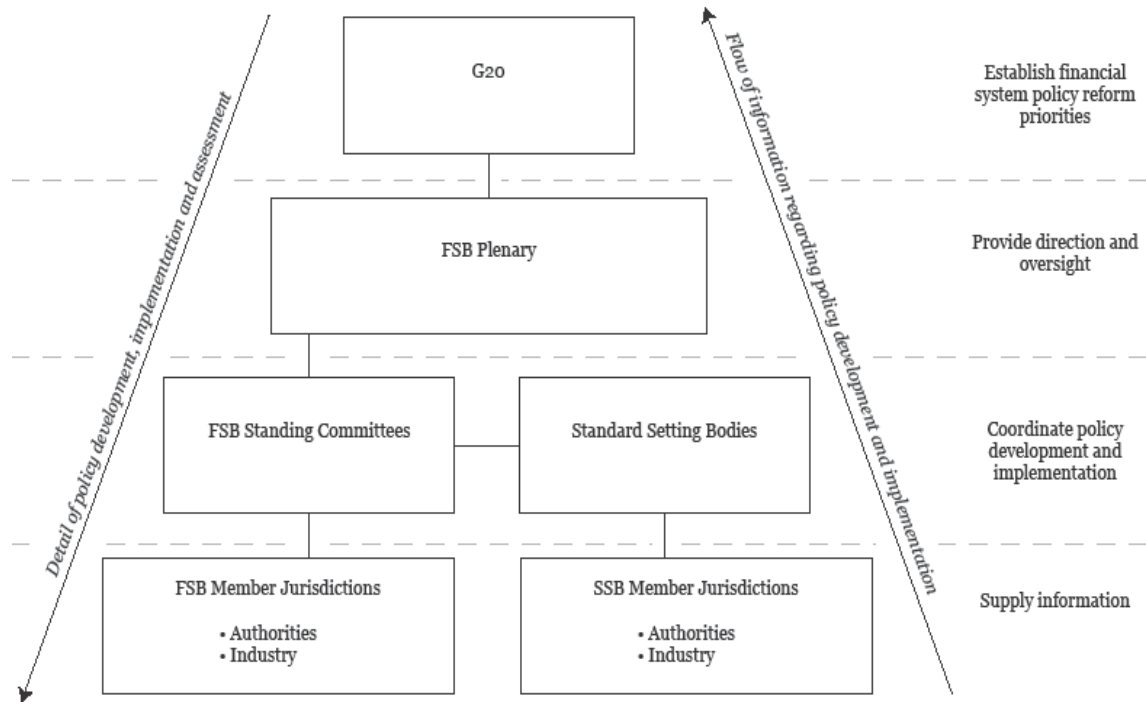
What is the FSB?

- 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

- 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

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- **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

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- 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>