

## **Roadmap and workshop for reducing reliance on CRA ratings**

### **FSB report to G20 Finance Ministers and Central Bank Governors**

The 20 February 2012 FSB progress report to the G20 Ministers and Governors on reducing reliance on credit rating agency (CRA) ratings reported overall slow progress to date and the need for greater coordination and, in some cases, impetus. This led the Ministers and Governors' communique to call for further progress by national authorities and standard setting bodies in this area.

Since then, in the June 2012 Los Cabos Declaration, the G20 Leaders further emphasised the need for faster progress, calling for work by national authorities and standard setting bodies in ending the mechanistic reliance on credit ratings to be accelerated and encouraging steps that would enhance transparency of and competition among credit rating agencies.

This note takes up again the issue of potential next steps, and sets out a roadmap for taking forward work to accelerate implementation of the FSB Principles<sup>1</sup>.

In its February progress report, the FSB stated that it would report back to G20 in November 2012 on remaining areas of reliance on CRA ratings at the level of individual standard setters and jurisdictions, and the next steps and short-term and medium-term milestones to achieve progress in these areas.

In particular, the FSB's February report stated that:

“The key challenge is developing alternative risk assessment capabilities and processes, so that use of CRA ratings is able to be no more than an input to risk assessment. Work needs to progress from stock-taking exercises of current regulatory reliance on CRA ratings to action plans for identifying how standards can more actively encourage the use of market participants' own risk management capabilities. In this respect, for instance, the BCBS work during 2012, to develop proposed policy responses in areas of the capital framework where external ratings reliance is greatest, will be important.

Authorities need to share experiences and effective practices in incentivising the market to develop adequate risk management capacity, and to establish timetables and milestones for

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<sup>1</sup> The October 2010 FSB report through which the Principles for Reducing Reliance on CRA Ratings were originally issued stated that “standard setters and regulators should incentivise a transition to a reduced reliance on CRA ratings over a reasonable timeframe extending into the medium term, taking into account the need for market participants to build up their own risk management capabilities to replace reliance on CRA ratings, but with clear milestones.”

the transition in order to provide an assurance of momentum. International organisations such as the SSBs or the FSB can act as fora to exchange information in a relatively structured way that supports international consistency, building on the information exchange that has already taken place on the existing extent of reliance on CRA ratings.

The FSB will work with its members to identify practical steps to take in the short term and milestones for ending mechanistic reliance on CRA ratings over the medium term, building on experience to date. As part of this:

- Standard setters should organise further sharing of lessons among their members, through workshops or other means, on approaches to reduce reliance and to promote increased capacity by market participants to conduct their own credit risk assessments. The FSB should hold a workshop within its membership by September 2012, bringing standard-setters and authorities together to compare lessons across the financial subsectors and discuss ways forward.
- The FSB should report back to the G20 Finance Ministers and Central Bank Governors at their November 2012 meeting on remaining areas of reliance on CRA ratings at the level of individual standard setters and jurisdictions, and the next steps and short-term and medium-term milestones to achieve progress in these areas.”

## **Proposal for roadmap and workshop**

To assist in accelerating the process as requested by G20 Leaders, this note proposes:

- **a roadmap** with milestones for concrete action, for submission to the 4-5 November 2012 G20 Finance Ministers and Central Bank Governors meeting;
- as an initial step in the work, **the outline for a workshop**, to take place in late November, to enable standard-setters, authorities and the private sector to exchange experiences, as different financial sectors face similarities in the challenges of incentivising and achieving a strengthening in firms’ own credit risk assessment processes to replace their remaining mechanistic reliance on CRA ratings.

### ***Roadmap***

The roadmap on page 4 consists of two tracks:

- Work to reduce mechanistic reliance on CRA ratings through standards, laws and regulations. These reviews should cover the identification and reduction of references to CRA ratings in standards, laws and regulations. The reviews should also identify whether, even absent such references to CRA ratings, sufficient steps are being taken in standards, laws and regulations to actively place a duty or expectation on market participants that they will not mechanically rely on CRA ratings;
- Work by authorities to promote and, where needed, require that financial institutions strengthen and disclose information on their own credit risk assessment approaches as a replacement for mechanistic reliance on CRA ratings.

These two tracks will need to progress in parallel, since changes in rules are needed to provide the incentive for market participants to develop their own credit risk assessments, while at the

same time mechanistic reliance can only be safely ended if market participants have developed such assessment capacity. The tentative roadmap is therefore designed with such a parallel process to incentivise change and at the same time allow time for adjustment.

As noted in the roadmap, the stock-taking by national authorities of existing reliance on CRA ratings and of reforms to reduce reliance is an important early part of the roadmap. The FSB could assist in this stock-taking, for instance through a thematic peer review focusing on existing practices and drawing lessons going forward. The SCSI could consider such a topic among the options when it discusses later this year topics for future peer reviews.

### ***Workshop***

A one-day workshop will be held on 19 November in New York to share experiences between national authorities, standard setters and the private sector in implementing the FSB's Principles for Reducing Reliance on CRA Ratings. Since the Principles were issued there has been a variety of separate initiatives by different national authorities, standard setting bodies, and industry sectors to take stock of existing reliance and to take steps to implement the Principles. The workshop will provide an opportunity to take stock more broadly of the progress made to date, to compare experiences, and to distil lessons and good practices. These lessons will form an input to the more detailed formulation of actions, milestones and timelines to achieve fuller adoption of the Principles.

Reflecting the content of the Principles themselves, the workshop will be divided into two sections, as described on page 5 of this note. The first section, to be conducted on the morning of the workshop, would invite selected market participants (from both private and public sector) to share their experiences on reducing the role of CRA ratings in their own approaches to credit risk management. Attention will be paid to reducing mechanistic reliance on CRA ratings both by bank and non-bank financial entities, particularly pension funds, institutional investors and insurance companies.

The afternoon section will be devoted to presentations by the official sector and will be an opportunity to compare experiences without private sector participation. Each of the relevant standard setting bodies will be invited to give presentations on their work on reducing references to CRA ratings in international standards; jurisdictions that have taken major initiatives in the area could also present their experiences.

## Roadmap with potential timelines

1: Reduce references to CRA ratings in standards, laws and regulation		
BCBS:	<p><b>Complete work to identify remaining elements of the Basel framework that will be reviewed for potential to reduce the reliance on CRA ratings</b> across the Basel framework</p> <p><b>Develop policy proposals</b> for alternative approaches to mechanistic reliance on CRA ratings.</p> <p><b>Adoption by jurisdictions</b></p>	<p>end-2012</p> <p>Mid-2014</p> <p>January 2016</p>
IOSCO, IAIS, OECD	<p><b>Provide guidance</b> to members on steps to further discourage reliance on CRA ratings</p>	<p>end-2013</p>
National authorities:	<p><b>Complete the stock-taking</b> of legislation/regulation for potential reform (supervisors, central banks, market regulators, finance ministries), possibly followed by peer review</p> <p><b>Identify/prioritise areas</b> for changes and publicly disclose action plan</p> <p><b>Propose alternative approaches</b> to CRA references/requirements for public comment</p> <p><b>Confirm final changes</b></p> <p><b>Implementation</b> by market participants is completed</p>	<p>mid-2013</p> <p>mid-2013</p> <p>mid-2014</p> <p>end-2014</p> <p>end-2015</p>
2: Strengthen credit assessment capabilities		
SSBs:	<p><b>Lead discussion(s)</b> across members to share ideas and experiences, and to better define best practice</p>	<p>Ongoing</p>
National Authorities (Policy):	<p><b>Promote best practice:</b> organise roundtable discussions across public sector, industry, and academia</p> <p><b>Develop guidance</b> regarding formulation and disclosure of appropriate risk assessment practices</p> <p><b>Encourage disclosure</b> by financial institutions of information about their credit risk assessment approaches as part of their public reporting</p>	<p>Ongoing</p> <p>mid-2014</p> <p>end-2013</p>
Public sector investors	<p>Public sector bodies that are investors or market participants <b>disclose information</b> about credit risk assessment approaches and strategy to achieve FSB Principles</p> <p><b>Participate</b> in national authorities' roundtable discussions at international/national levels</p>	<p>end-2013</p> <p>Ongoing</p>

## **Proposed format of workshop (19 November 2012, New York)**

### **First Section: Open to public and private sector.**

1. Internal limits and investment policies of banks, investment managers and institutional investors
  - a. Perspectives of variety of market participants, such as: central bank, bank, large investment manager, smaller investment manager, insurance company, hedge fund
2. Credit policies in margin agreements
  - a. Perspectives of derivatives market participants and financial market infrastructures
3. Disclosures by issuers
  - a. Perspectives of issuers and underwriters

### **Second Section: Public Sector participation only**

1. Reducing reliance on CRA ratings by public sector investment managers
  - a. Central bank money market and reserves management perspective
  - b. Sovereign Wealth Fund perspective
2. Standard setters' actions and further role in reducing reliance on CRA ratings
  - a. BCBS
  - b. IOSCO
  - c. IAIS
3. National case studies on reducing CRA reliance
4. Conclusions and lessons for the future