

Thematic peer review on the FSB Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings

Questionnaire

Introduction

In October 2010, the FSB issued [*Principles for Reducing Reliance on CRA Ratings*](#). The goal of the Principles is to end mechanistic reliance on CRA ratings by banks, institutional investors and other market participants. The “hard wiring” of CRA ratings in regulation has been wrongly interpreted as providing those ratings with an official “seal of approval” and has reduced incentives for firms to develop their own capacity for credit risk assessment and due diligence. As demonstrated during the financial crisis, reliance on external ratings to the exclusion of internal credit assessments can be a cause of herding behaviour and of abrupt sell-offs of securities when they are downgraded (“cliff effects”). These effects can amplify procyclicality and cause systemic disruption.

Following a February 2012 progress report by the FSB Secretariat, both the G20 Finance Ministers and Central Bank Governors as well as the G20 Leaders, in their Los Cabos Declaration, called for faster progress by national authorities and SSBs in ending mechanistic reliance on credit ratings. In response to this call, the FSB Plenary at its meeting in Tokyo in October 2012 endorsed a roadmap¹ with timelines to accelerate implementation of the FSB Principles, which were welcomed at the November 2012 G20 Finance Ministers and Central Bank Governors meeting.

The roadmap consists of two tracks:

- Work to reduce mechanistic reliance on CRA ratings through standards, laws and regulations. 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 mechanistically rely on CRA ratings;
- Work to promote and, where needed, require financial institutions to strengthen their own credit risk assessment processes as a replacement for reliance on CRA ratings, and disclose information on those processes.

To this end, the FSB is undertaking a thematic peer review, whose main objective is to assist national authorities fulfil their commitments under the agreed CRA ratings roadmap. The aim of the review is to accelerate progress in reducing mechanistic reliance on CRA ratings by

¹ The Roadmap is available at http://www.financialstabilityboard.org/publications/r_121105b.pdf.

facilitating the sharing among national authorities of experiences and effective practices, including by encouraging market participants to develop and implement adequate credit assessment processes.

The peer review will focus on certain Principles, as highlighted in the questionnaire, that relate to regulatory and supervisory practices or the official sector more broadly. More specifically, the review will:

- Take stock of the extent to which references to CRA ratings in national laws and regulations have been identified, assessed and (where appropriate) removed or replaced with suitable alternative standards of creditworthiness;
- Highlight good practices and lessons of experience from assessing, removing and/or replacing references to CRA ratings in laws and regulations;
- Identify any challenges that have arisen in seeking to remove or replace references as set out in the Principles, and highlight potential solutions where these have been developed; and
- Review national authorities' progress and plans to encourage disclosure by financial institutions of information about their credit assessment processes and to further strengthen those capabilities.

The primary source of information for the peer review will be member jurisdictions' responses to this questionnaire. The questionnaire is divided into four sections:

- Section 1 covers the measures taken to reduce references to CRA ratings in laws and regulations (Principle I);
- Section 2 covers the measures taken by the official sector to reduce market reliance on CRA ratings (Principle II);
- Section 3 covers the detailed measures taken by the relevant official sector authorities to implement the detailed application of the Principles (Principle III);
- Section 4 concerns general observations on the implementation of the Principles.

National authorities should provide a consolidated response that covers all financial sub-sectors in their jurisdiction. Responses from Member States of the European Union should indicate where the responsibility for addressing a specific question resides with the European Commission or one of the European authorities (ESMA, EBA, or EIOPA). Respondents are encouraged to draw on their responses to prior surveys in this area where those are relevant for this questionnaire. The Peer Review Team will follow up with jurisdictions, as necessary, concerning plans indicated in this questionnaire before finalizing the peer review report. Jurisdictions are also encouraged to provide updated information to the attention of the Peer Review Team as plans develop or experience is gained over the coming months.

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)

General

1. Please describe the process that was used to assess references to CRA ratings in your laws and regulations for the financial sector:²

a) Did the authorities in your jurisdiction conduct a review of laws and regulations following publication of the CRA Principles in October 2010?

If yes:

b) Which supervisory or other authorities were involved in the assessment?

c) What steps, if any, were taken to coordinate the approach taken by the relevant authorities?

d) Over what timeframe were the assessments conducted?

e) If the assessments resulted in proposals for legislative and/or regulatory change, which authorities were responsible for implementing the proposed changes?

f) How many of the proposed legislative and/or regulatory changes have already been adopted?

g) How many legislative and/or regulatory changes remain to be made and what is the timetable for their adoption?

h) Has the assessment been updated following the adoption of the FSB roadmap?

If no:

i) Please describe the plans by your jurisdiction to conduct a review of laws and regulations in line with the FSB roadmap.

2. Please describe the process that is being used to develop action plans for your jurisdiction as called for under the roadmap:

a) Which supervisory or other authorities are involved in the development of the action plan? To what extent is the private sector involved in this process?

b) What steps, if any, are being taken to coordinate the approach taken by the relevant authorities?

c) What is the current status of the action plan for your jurisdiction?

d) What is the timeframe, if any, for the completion and full implementation of the action plan?

² As the definition of each of these categories of institutions may differ across FSB member jurisdictions, respondents are asked to provide a definition of the relevant entities included under each of these categories.

References to CRA ratings in laws and regulations

For the following questions please provide separate responses for each of the following categories:

Banks

Insurance/reinsurance companies

Investment funds management, including:

- Collective investment schemes (i.e. schemes investing in transferrable securities such as mutual funds)
- Alternative investment schemes (e.g. hedge funds, endowments etc.)
- Occupational retirement schemes

Collateral policies for central counterparties (CCPs)

Securities issuance, including asset-backed securities and corporate debt

Securities firms (broker-dealers)

3. Please provide details (using [Annex I](#)) of all specific laws and regulations from which references to CRA ratings were removed or have been proposed to be removed following the assessment described in answer to Question 1. Please use [Annex I](#) to provide details of:
 - a) The specific law/regulation reference
 - b) The text of the relevant law/regulation
 - c) The replacement text (where applicable)
 4. Please provide details (using [Annex I](#)) of all laws and regulations where references to CRA ratings have been identified but were not replaced.
 - a) Where references to CRA ratings were identified but not replaced or proposed to be replaced, what were the factors that lead to these references being retained?
 - b) Will the decision not to replace the references be reviewed in the future?
 - c) What factors might trigger a review?
 5. Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions (using [Annex I](#)).
 6. Please describe the measures of creditworthiness that you have considered as alternatives to credit ratings. What do you consider as the main advantages and weaknesses of each of these alternative creditworthiness measures?
- 2. Reducing market reliance on CRA ratings (Principle II)**
1. Please describe any roles played by regulatory authorities in your jurisdiction in reviewing credit risk assessment capabilities of market participants.
 2. To what extent are the regulatory authorities directly involved in developing alternative credit risk assessment processes?

3. Please describe (using [Annex I](#)) any supervisory processes and procedures used to check the adequacy of market participants' own credit assessment processes in respect of:

Banks

Insurance/reinsurance companies

Investment funds management, including:

- Collective investment schemes (i.e. schemes investing in transferrable securities such as mutual funds)
- Alternative investment schemes (e.g. hedge funds, endowments, etc.)
- Occupational retirement schemes

Collateral policies for central counterparties (CCPs)

Securities issuance, including asset-backed securities and corporate debt

Securities firms (broker-dealers)

- a) Please describe (using [Annex I](#)) any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.
4. What measures have authorities in your jurisdiction adopted to incentivise market participants to develop their internal risk management capabilities?
- a) Please describe separately any additional measures taken since the publication of the FSB CRA Principles.
- b) What role is played by CRA ratings as part of internal credit risk management approaches for each of the above categories of market participants?
- c) To what extent are market participants required to disclose information about their internal credit risk assessment processes?

3. Application of the basic principles to particular financial market activities (Principle III)

Please refer to [Annex I](#)

4. General

- a) What are the main lessons to be drawn from the assessment and implementation process followed by the authorities in your jurisdiction?
- b) What have been the greatest obstacles to implementing the CRA Principles?
- c) Please describe any specific policies or measures that you believe have been particularly effective in reducing reliance on CRA ratings.
- d) Do you have any specific recommendations for amending the CRA Principles on the basis of your implementation experience?
- e) Are there any other general observations you would like to make about the CRA Principles or their implementation?

Annex I: Banks³

Please complete Annex I for each category ([banks](#), [insurance/reinsurance companies](#), [investment funds management](#), [collateral policies for central counterparties](#), [securities issuance](#) and [securities firms](#)). In case of a category not included, please include it in end).

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)					
<i>References to CRA ratings in laws and regulations</i>					
3. References in laws and regulations that have been removed or proposed to be removed.	Law/regulation Article/section number				
	Text removed or proposed to be removed (in English if available or brief description)				
	Replacement text (where applicable) (If text is not available please provide a brief description of proposed changes)				
4. References identified but not removed or proposed to be removed.	Law/regulation Article/section number				
	Text identified not to be removed (in English if available or brief description)				
	Reason for non-removal				
	Factors that would lead to a review				
5. Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of					

³ Including central banks, where relevant.

<p>replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions.</p>	
<p>2. Reducing market reliance on CRA ratings (Principle II)</p>	
<p>3. Please describe any supervisory processes and procedures used to check the adequacy of market participants' own credit assessment processes in respect of banks</p>	
<p>3.a Please describe any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.</p>	
<p>3. Application of the basic principles to particular financial market activities (Principle III)</p>	
<p><i>III.1 Central bank operations (Principle III.1)</i></p>	
<p>a. Please describe the role played by CRA ratings in central bank policies (such as investments, asset management frameworks, and conventional and unconventional operations), including the decision to accept or reject an instrument as collateral or for outright purchase and in determining haircuts. Please indicate the differences, if any, that apply to policies adopted according to the type of operation being undertaken e.g. collateral accepted to implement monetary policy operations vs reserves.</p>	
<p>b. Does your central bank impose risk control measures (including haircuts) on financial instruments based on internal credit assessment? Please describe these risk control measures where appropriate.</p>	
<p>c. Does your central bank impose risk control measures (including haircuts) on financial instruments where these have not been subject to internal credit assessment? Please describe these risk control measures where appropriate.</p>	

	d. Please provide details of policies for which the role played by CRA ratings has been adjusted in line with the FSB Principles.	
	e. Please describe any actions taken or planned to develop your central bank's internal credit risk assessment capabilities and use of alternative measures of creditworthiness. What were the factors that led to this decision? Where such measures have not been adopted what were the factors in this decision?	
III.2 Prudential supervision of banks (Principle III.2)		
Internal Ratings Based Approaches	a. Has your jurisdiction adopted the Basel II capital adequacy framework? Are Internal Ratings Based (IRB) Approaches a permitted part of that framework?	
	b. How many banks in your jurisdiction have been approved to use the IRB Approaches? What is the approximate proportion of total banking system exposures whose credit risk weights as at end-2012 were being measured using IRB Approaches?	
	c. Please describe any national supervisory criteria that banks must satisfy to use the IRB approaches.	
	d. Please describe your supervisory approach to IRB banks, detailing in particular the process for reviewing banks' internal credit assessment processes to ensure that these do not place excessive reliance on CRA ratings.	
	e. Please describe any additional measures that supervisors in your jurisdiction take to ensure that IRB banks develop adequate internal credit assessment processes that avoid excessive reliance on CRA ratings.	

<i>Standardised Approach</i>	a. How many banks in your jurisdiction use the Standardised Approach?	
	b. What measures do supervisors in your jurisdiction take to ensure that banks using the Standardised Approach develop adequate internal credit assessment processes that avoid excessive reliance on external ratings?	
	c. What plans, if any, do supervisors in your jurisdiction have to encourage banks currently using the Standardised Approach to migrate to one of the IRB Approaches? What are the current obstacles to more widespread adoption of the IRB Approaches?	
<i>Other prudential policies</i>	a. Are any banks in your jurisdiction subject to a capital adequacy regime that is neither the IRB nor Standardised Approach (e.g. smaller deposit-taking institutions)? If so, please describe this regime and give the number of banks subject to it and the percentage of banking system assets that they represent.	
	b. What measures do supervisors in your jurisdiction take to ensure that these banks develop adequate internal credit assessment processes that avoid excessive reliance on external ratings?	
	c. What roles, if any, do CRA ratings perform in other prudential supervisory policies (e.g. relating to liquidity requirements)? Please describe any measures that have been taken or are proposed to reduce reliance on CRA ratings in these areas.	

Annex I: Insurance/Reinsurance Companies⁴

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)					
<i>References to CRA ratings in laws and regulations</i>					
3. References in laws and regulations that have been removed or proposed to be removed.	Law/regulation Article/section number				
	Text removed or proposed to be removed (in English if available or brief description)				
	Replacement text (where applicable) (If text is not available please provide a brief description of proposed changes)				
4. References identified but not removed or proposed to be removed.	Law/regulation Article/section number				
	Text not removed (in English if available or brief description)				
	Reason for non-removal				
	Factors that would lead to a review				
5. Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions.					

⁴ Answers in this section should relate to the prudential regulation of insurance companies and reinsurance companies. Laws and regulations relating to insurance companies in their capacity as institutional investors should be included in the section entitled “Investment Funds Management.”

2. Reducing market reliance on CRA ratings (Principle II)	
3. Please describe any supervisory processes and procedures used to check the adequacy of market participants' own credit assessment processes in respect of insurance/reinsurance companies.	
3.a Please describe any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.	

Annex I: Investment Funds Management (including collective investment schemes, alternative investment schemes, occupational retirement schemes)

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)					
<i>References to CRA ratings in laws and regulations</i>					
3. References in laws and regulations that have been removed or proposed to be removed.	Law/regulation Article/section number				
	Text removed or proposed to be removed (in English if available or brief description)				
	Replacement text (where applicable) (If text is not available please provide a brief description of proposed changes)				
4. References identified but not removed or proposed to be removed.	Law/regulation Article/section number				
	Text not removed (in English if available or brief description)				
	Reason for non-removal				
	Factors that would lead to a review				
5. Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions.					

2. Reducing market reliance on CRA ratings (Principle II)				
3. Please describe any supervisory processes and procedures used to check the adequacy of market participants' own credit assessment processes in respect of investment funds management				
3.a Please describe any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.				
3. Application of the basic principles to particular financial market activities (Principle III)				
<i>III.3 Internal limits and investment policies of investment managers and institutional investors (Principle III.3c)</i>				
In answering questions on Principle III.3c please provide separate responses in respect of the following:				
<ul style="list-style-type: none"> • Insurance companies (in their capacity as institutional investors). • Investment managers (i.e. managers of collective investment schemes). • Alternative investment managers (e.g. hedge funds, endowments etc.) • Managers of occupational retirement schemes. 				
	Insurance companies (in their capacity as institutional investors).	Investment managers (i.e. managers of collective investment schemes).	Alternative investment managers (e.g. hedge funds, endowments etc.)	Managers of occupational retirement schemes.
a.	Please describe the role played by CRA ratings in setting the internal limits and investment policies of investment managers and institutional investors in your jurisdiction.			
b.	What role is played by supervisors in your jurisdiction in reviewing the internal limits and investment policies of investment managers and institutional investors?			

<p>c. What powers do supervisors in your jurisdiction possess to require changes to internal limits and investment policies? Please give examples of how those powers have been exercised to incentivise compliance with the CRA Principles.</p>				
<p>d. If internal limits and investment policies are not routinely reviewed as part of the supervisory process, what additional reviews have been undertaken or are planned of these limits and policies to ensure compliance with the CRA Principles?</p>				
<p>e. Have supervisors in your jurisdiction any evidence that investment managers and institutional investors have made changes to the role that CRA ratings play in investment mandates, thresholds and triggers following the publication of the CRA Principles?</p>				

Annex I: Collateral Policies for Central Counterparties

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)					
<i>References to CRA ratings in laws and regulations</i>					
3. References in laws and regulations that have been removed or proposed to be removed.	Law/regulation Article/section number				
	Text removed or proposed to be removed (in English if available or brief description)				
	Replacement text (where applicable) (If text is not available please provide a brief description of proposed changes).				
4. References identified but not removed or proposed to be removed.	Law/regulation Article/section number				
	Text not removed (in English if available or brief description)				
	Reason for non-removal				
	Factors that would lead to a review				
5. Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions.					

2. Reducing market reliance on CRA ratings (Principle II)	
3. Please describe any supervisory processes and procedures used to check the adequacy of market participants' own credit assessment processes in respect of collateral policies for central counterparties.	
3.a Please describe any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.	
3. Application of the basic principles to particular financial market activities (Principle III)	
<i>III.4 Central counterparties and private sector margin agreements (Principle III.4a)</i>	
a. Please describe the role played by ratings in the margin requirements (initial margin models, valuation models) and risk assessments processes (backtesting, sensitivity analysis) of the CCPs under your jurisdiction.	
b. Have the CCPs or the supervisory authorities conducted stress tests or estimated the procyclical effect, on the overall margin requirements for the CCP participants, of a sudden downgrade of the credit ratings of some widely used securities?	
c. Have the CCPs or the supervisory authorities assessed the reliance on credit ratings in the investment policy of the CCP?	
d. What role is played by supervisors in your jurisdiction in reviewing private sector margin agreements?	
e. What powers do supervisors in your jurisdiction possess to require changes to private sector margin agreements? Please give examples of how those powers have been exercised to incentivise compliance with the CRA Principles.	
f. If private sector margin agreements are not routinely reviewed as part of the supervisory process, what additional reviews have been undertaken or are planned of these agreements to ensure compliance with the Principle?	

Annex I: Securities Issuance (debt and equity, whether public issuance or private placement), including asset-backed securities and corporate debt

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)					
<i>References to CRA ratings in laws and regulations</i>					
3. References in laws and regulations that have been removed or proposed to be removed.	Law/regulation Article/section number				
	Text removed or proposed to be removed (in English if available or brief description)				
	Replacement text (where applicable)				
4. References identified but not removed or proposed to be removed.	Law/regulation Article/section number				
	Text not removed (in English if available or brief description)				
	Reason for non-removal				
	Factors that would lead to a review				
5. Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions.					
2. Reducing market reliance on CRA ratings (Principle II)					
3. Please describe any supervisory processes and procedures used to					

<p>check the adequacy of market participants' own credit assessment processes in respect of securities issuance.</p>	
<p>3.a Please describe any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.</p>	
<p>3. Application of the basic principles to particular financial market activities (Principle III)</p>	
<p><i>III.5 Disclosures by issuers of securities (Principle III.5a)</i></p>	
<p>a. Please describe the role played by CRA ratings in disclosures by issuers of debt and equity securities in your jurisdiction (whether public issuance or private placement).</p>	
<p>b. What role is played by supervisors in your jurisdiction in reviewing the role played by credit ratings in disclosures by issuers of securities?</p>	
<p>c. Please give examples, if possible, of measures taken to reduce the role of credit ratings in disclosures by issuers of securities.</p>	

Annex I: Securities Firms (broker-dealers)

1. Reducing reliance on CRA ratings in laws and regulations (Principle I)					
<i>References to CRA ratings in laws and regulations</i>					
3.	References in laws and regulations that have been removed or proposed to be removed.	Law/regulation Article/section number			
		Text removed or proposed to be removed (in English if available or brief description)			
		Replacement text (where applicable)			
4.	References identified but not removed or proposed to be removed.	Law/regulation Article/section number			
		Text not removed (in English if available or brief description)			
		Reason for non-removal			
		Factors that would lead to a review			
5.	Where CRA ratings are used to assess creditworthiness, have you developed alternative standards of assessment for the purpose of replacing references to CRA ratings in laws and regulations? Where applicable, please provide these alternative definitions.				
2. Reducing market reliance on CRA ratings (Principle II)					
3.	Please describe any supervisory processes and procedures used to check the adequacy of market participants' own credit assessment processes in respect of securities firms.				
3.a	Please describe any specific procedures that have been adopted to guard against upward biases in firms' internal ratings.				