

Press release

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FSB publishes thematic peer review report on reducing reliance on credit rating agency (CRA) ratings

The Financial Stability Board (FSB) published today the final [peer review report](#) on national authorities' implementation of the FSB Principles for Reducing Reliance on CRA Ratings ('Principles'). The report is complemented by the publication of the action plans for each FSB jurisdiction, which can be found at http://www.financialstabilityboard.org/publications/c_140429.htm.

At the St Petersburg G20 Summit and subsequent meetings, the G20 called on national authorities to accelerate progress in implementing the FSB Principles in accordance with the FSB [roadmap](#) agreed in October 2012. The roadmap sets out milestones for work to reduce mechanistic reliance on CRA ratings in standards, laws and regulations, and to promote and, where needed, require that financial institutions strengthen and disclose information on their own credit assessment approaches.

As follow-up, the FSB conducted a thematic peer review of national authorities' implementation of the FSB Principles in two stages. The first stage, completed in [August 2013](#), comprised a stocktake of references to CRA ratings in national laws and regulations. The current second stage focused on the action plans developed by national authorities to implement the FSB roadmap.

The review found that progress toward the removal of references to CRA ratings from standards, laws and regulation has been uneven across jurisdictions and the financial sectors. Even so, removing references to CRA ratings from laws and regulations is only the first step; mechanistic reliance on CRA ratings can also come from market practices and contracts. The key challenge lies in developing alternative standards of creditworthiness and processes so that CRA ratings are not the sole input to credit risk assessment.

National authorities therefore need to focus on establishing stronger internal credit risk assessment practices. In some instances, this may entail a fully independent risk assessment, and in other instances this may allow using CRA ratings as one indicator, amongst others, of credit risk.

All FSB members have prepared action plans, which represent significant steps toward reducing reliance on CRA ratings in standards, laws and regulations. The action plans vary in scope and detail because of different starting points across jurisdictions. A common challenge faced by national authorities is in developing proposals for alternative definitions of creditworthiness and incentives for market participants to enhance their own risk assessment processes.

In the light of these findings and in support of the review conclusion that more could be done to address gaps in individual action plans, the peer review set out several recommendations

to address some of the challenges hindering progress toward implementation of the roadmap. In particular, national authorities should:

- implement their action plans and refine them as lessons of experience are gained.
- engage market participants to encourage: adoption of alternative approaches such as strengthening of internal credit assessment processes; and reviewing reliance on CRA ratings in private contracts, such as ratings triggers, which represent mechanistic reliance on CRA ratings.
- not replace mechanistic reliance on CRA ratings with mechanistic reliance on a very limited number of alternative measures, as this might lead to substituted procyclicality and herd behaviour.

The review also addressed a few recommendations to the standard-setting bodies.

Ravi Menon, Managing Director of the Monetary Authority of Singapore and Chairman of the FSB's Standing Committee on Standards Implementation (SCSI) that oversaw the preparation of the peer review, said "The objective is not to eradicate CRA ratings but to promote sound judgement in assessing creditworthiness. This means taking account of a more comprehensive set of factors besides CRA ratings. We have made some progress in reducing reliance on CRA ratings but there is still some way to go in identifying an array of practical and suitable complements to CRA ratings."

Notes to editors

The peer review on national implementation of the FSB *Principles for Reducing Reliance on CRA Ratings* is the ninth thematic review conducted by the FSB. Peer reviews are conducted according to the objectives and guidelines set out in the January 2014 [Handbook for FSB Peer Reviews](#). All peer reviews completed to date are available on the [FSB website](#).

The FSB published [Principles for Reducing Reliance on CRA Ratings](#) in October 2010. The goal of the Principles is to end mechanistic reliance on ratings and establish stronger internal credit risk assessment practices instead. 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. Widespread CRA rating downgrades since the Principles were issued have underscored these concerns.

At the St Petersburg G20 Summit, and subsequent meetings, the G20 has called on national authorities to accelerate progress in reducing mechanistic reliance on credit rating agency (CRA) ratings in accordance with the FSB [roadmap](#) agreed in October 2012 (the roadmap). The roadmap consists of two tracks: work to end mechanistic reliance on CRA ratings through standards, laws and regulations; and 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.

In order to support the agreed roadmap, the FSB decided to undertake a thematic peer review, whose main objective is to assist national authorities in fulfilling their commitments under the roadmap. The review focused on those aspects of the Principles that are directly

addressed to the official sector and it was structured in two stages, the first of which – published in August 2013 – comprised a structured stocktaking of references to CRA ratings in national authorities’ laws and regulations and of actions taken and underway to reduce these references. The second and final stage – described in this report – focused on the action plans developed by national authorities to implement the roadmap.

The draft report was prepared by a team of experts drawn from FSB member institutions and led by Thomas J. Butler, Director of the Office of Credit Ratings in the US Securities and Exchange Commission.

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with 65 other jurisdictions through its six regional consultative groups.

The FSB is chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.