“The International Discussions on the Credit Rating Agencies and Enhancing Infrastructure to Strengthen the Regional Credit Rating Capacity in the ASEAN+3 Region”

Summary

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1. Background

ASEAN+3 recognized the importance of enhancing regional credit rating capacity as an indispensable market infra in promoting issuance of and cross-border investment into local currency-denominated bonds. Efforts have been made to standardize the rating terminologies and methodologies, but no visible advancement has been witnessed, yet. RCRA has also been proposed as a more substantial and practical alternative to pure private initiatives. This study evaluates available alternatives and makes relevant policy suggestions.

2. Global Discussions on CRA

Since the meltdown in the US credit market in 2008~2009, there have been calls for reform of credit rating market. Dodd-Frank Act requires CRAs liable as experts for deficiencies regarding credit rating. CRAs are also required to improve rating process in various ways. FSB and G20 set principles for reducing reliance on CRA ratings.

The EU also made CRA reforms since the subprime debacle. CRA 1 requires all CRAs with their credit ratings to be used in the EU to register. CRA 2 made ESMA have the exclusive supervision power on CRAs. CRA 3 proposals were made by the EC on the issues of over-reliance on credit ratings, more transparent and more frequent sovereign ratings, elimination of conflicts of interest, more accountable ratings.

3. A View on the Asian CRA Market

There exist about 30 DCRAs in the ASEAN+3 region. Many of them are affiliated with global big 3 CRAs, mostly concentrate their business in the local markets. Despite ACRAA’s efforts including the publication of “ACRAA Code of Conduct Fundamentals for Domestic Credit Rating Agencies”, Asian DCRAs’ ratings are not comparable across borders. It also seems that Asian DCRAs are hard to extend their coverage of ratings due to their small size and human capital compared to global CRAs.

4. RCRAs in Other Regions

CariCRIS is acknowledged as the 1st regional credit rating agency. It performs regional scale and national scale ratings and has released 107 ratings as of Nov. 2012. Its diversified shareholding limits the influence of individual shareholders, and it also maintains rating committee independent of the shareholders and the board.

In EU, there have been serious discussions about possible alternatives including a public European credit rating agency. Since EU was seeking for an option that can heighten the level of competition, options that require public expenditure were vetoed by the Congress.

5. Evaluations on Policy Alternatives

We evaluated two alternatives. Alt.1 ‘private initiatives’ is facilitating market initiatives by DCRAs with ACRAA which reflects the strategy pursued so far. Alt.2 ‘setting up a RCRA’ is literally setting up a regional credit rating agency collectively funded by ASEAN+3 member countries. Regarding Alt.1, it was concluded that future loss of benefits from indefinite delay in Asian bond market vitalization would exceed the current cost saving from pursuing private initiatives. Just as we haven’t seen meaningful progress toward RCR capacity, continuation of private initiatives wouldn’t bring about much change. For Alt.2, despite some financial burden and strenuous effort from the participating governments, this would promise to deliver what we hoped for in the first place, broader coverage, credit-cycle neutral ratings, streamlined regulation, all of which would contribute to investment growth, financial stability, and one more step closer to “Asia Bond Market.” To summarize, Alt.1 is an easy approach with little gain, while Alt.2 is an approach with some level of efforts with high expected gain. At least for now, to enhance credit rating capacity in ASEAN+3, establishing an RCRA seems to be the only substantial initiative.

6. Suggestions for the Future Roadmap

For our RCRA to succeed, its independence and accountability need to be secured. First, the directors should be appointed by various interest groups including the ASEAN+3. Second, the ASEAN+3 should exercise the authority on the RCRA only through the Rulebook that the ASEAN+3 devises. The ASEAN+3 would own a majority of shares of the RCRA, but the member countries can expect to cover running costs in the form of contribution only in the first few years.

The revenue of the RCRA would come from rating fees. The main target of rating in the short run should be public companies and project financing where the lack of rating coverage has been limiting long-term international financing. Moreover, the RCRA would try to issue more credit-cycle neutral sovereign ratings, thereby enhancing financial stability of each country.

The ASEAN+3 would make strenuous effort to streamline the regulatory framework. It not only devises the Rulebook to the international standards, but also further tries to harmonize the CRA regulation in the region. Since it is not feasible to have the RCRA subject to the supervision of each country, the member countries should first collectively recognize the RCRA and then create the "Regional Credit Rating Supervisory Committee" in light of the CESR in Europe.