



Evolving International Discussions on Credit Rating Agencies and Japanese Registration system for the Agencies : Can Japan's experience be any lesson to Asia?

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International discussions on Credit Rating Agencies

Credit rating, which started in the beginning of 20th century in the US, has now been deeply incorporated in the financial infrastructure as an indispensable factor that should be taken into account by the bond issuers, investors, and financial regulators not only in the advanced countries but also in the emerging economies.

Credit rating business had long been exempted from the financial controls but the collapse of the Enron Corp. of the US in 2001 and the following global financial crisis of 2007~2008 triggered an international discussion that argued for the necessity of introducing regulatory and supervisory system for the rating agencies.

At a time of the Enron's collapse, the credit rating market in the US was oligopolistically dominated by three major rating companies (namely Moody's, Standard and Poor's and Fitch) which maintained their high ratings to the Enron Corp. until just before its collapse. The discussions ranged from the conflict of interest between these rating agencies and the issuers rated, to the timing of their rating disclosures, and to the murky practice of the SEC to authorize the NRSRO (Nationally Recognized Rating Organization).

During the global financial crisis of 2007~2008, the following issues came under new review; were the methodology and data used for rating securitized instruments appropriate and fully reliable?; were there no conflicts of interest that resulted from the doubtful procedures in that the rating agencies might have given the clients favorable advices for a higher rating to their securitized instruments, and so on. Especially, the overreliance on these ratings by investors became a matter for concern since in times of economic slump it might trigger and accelerate a massive selling of those securities at an announcement to downgrade them, leading in turn to pro-cyclicality volatility.

International Discussions on Credit Rating Agencies

2003	IOSCO: Statement of Principles Regarding the Activities of Credit Rating Agencies (CRA)
2004	IOSCO: Code of Conduct Fundamentals for Credit Rating Agencies
2008	Financial Stability Forum (FSF): Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience
2008	IOSCO: The Role of Credit Rating Agencies in Structured Finance Market (revised Code of Conduct)
2008	G20 Summit: Washington Action Plan
2010	Financial Stability Board (FSB): Principles for Reducing Reliance on CRA Ratings
2011	IOSCO: Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies

(Source) Compiled by the IIMA from various sources

In response to these discussions, the IOSCO published in 2003 a statement on the “Principles Regarding the Activities of Credit Rating Agencies,” and again in 2004 in its revised form the “Code of Conduct Fundamentals for Credit Rating Agencies”. These were further expanded to incorporate the debates on the rating for securitized instruments (Revised Code of Conduct) in 2008. In 2010 the Financial Stability Board published the “Principles for Reducing Reliance on CRA Ratings” and many advanced countries have implemented, without much disturbance on the market, measures to repress and alleviate the overreliance on credit ratings by investors and regulators.

In the United States, the credit rating business has been placed under a harsher environment by the Dodd-Frank Act (i.e. Dodd-Frank Wall Street Reform and Consumer Protection Act) which was enacted to address issues arisen in the financial crisis of 2007~2008.

Japan's Registration system for the CRAs

Reflecting those international discussions noted above, Japan introduced in April 2010 a new registration system of the Credit Rating Agencies based on the revised Financial Instruments Exchange Act. Under this system, credit rating agencies which are well organized to perform the credit rating business on a fair and accurate manner “can apply for the registration by the Prime Minister (delegated to the Commissioner of the FSA)” and thus registered CRAs are to be subject to the control and supervision of the Financial Service Agency. It is possible to do credit rating business without registration, but for the purpose of investor protection, the financial instruments intermediary service providers are obliged to declare so if they utilize the ratings provided by unregistered CRAs. At present, 7 CRAs have been registered under the present system¹.

The registered CRAs are subject to such regulations as on duty of good faith to the customers, on information disclosures (publication of rating policies), on establishment of operation control systems and on prohibited acts (provision of rating service to the rating stakeholders whose financial instruments rated by the CRA itself it owns, or provision of consulting activities to the rated company, etc). The Financial Services Agency that acts as a supervisory agency to the CRAs does not supervise the contents of the credit rating business operations themselves but rather oversees through collecting reports and on-site inspections the adequacy of their operational systems and procedures in view of the regulations on the CRAs. These regulations also include the orders for business improvement or business suspension and the provision for rescission of registration.

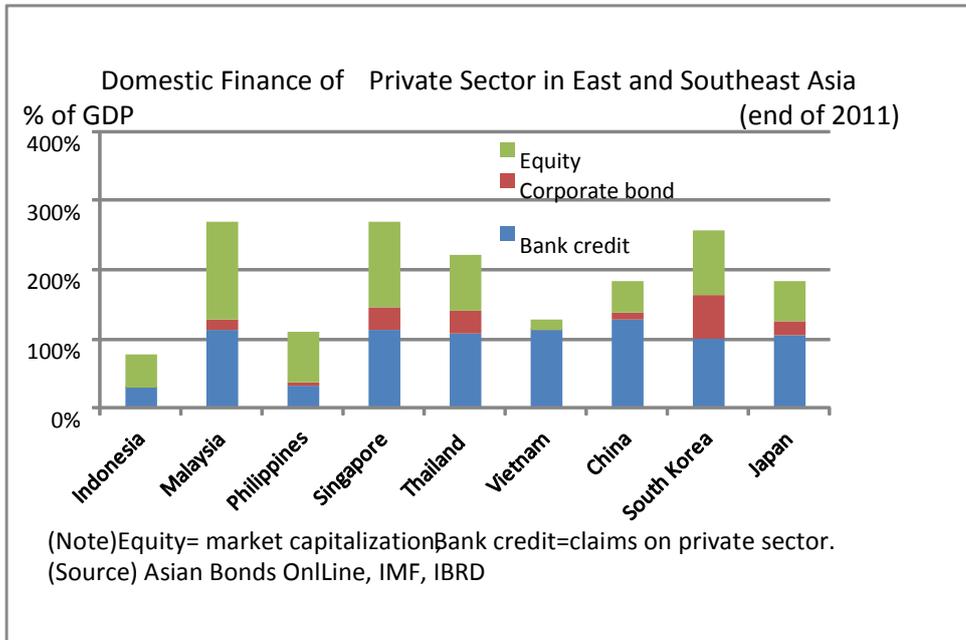
CRAs in East Asia

Currently, there are about 30 CRAs that conduct the credit rating business in East Asia. Singapore, which is one of the countries that have the most developed corporate bond market in the region, has no domestic CRAs and three global CRAs of the US and Europe origin dominate the market. Neither has Vietnam its own CRAs and credit rating business is conducted by three global CRAs of the US and Europe origin and one Japanese CRA.

In contrast to the case of Japan, CRAs in these countries are subject to permission system where credit rating business can be conducted only by the bodies licensed by the authorities. In these countries the credit rating business has been an important part of their money and capital

¹ Of which 5 CRAs are affiliated to the big three CRAs of the US and Europe which conduct their business in a global market.

market infrastructures and in such countries as China, Indonesia, Korea, Malaysia, Philippines and Thailand, corporate bond issuing has been conditioned to getting a rating of a certain level or higher².



The domestic CRAs in East Asia are faced with the following common problems in their business; (1) the size of bond market is smaller compared to the banking credit; (2) the international credibility and recognition of the domestic CRAs is rather low; (3) they often tend to provide different ratings from the global CRAs and (4) it is not easy to inter-compare the ratings even among the East Asian countries. More or less Japan is no exception to these problems.

In Japan, efforts have been made to counter these problems. In the institutional aspect, the framework of regulation and supervision has been improved under the registration system as explained above, while the individual CRAs have been trying to enhance their credibility by refining their rating methods and models and strengthening their performance analysis as well as trying to expand the market of information business.

In Asia, on the other hand, efforts have been made through the ACRAA (Association of

² In Japan, requirement of gaining a rating to satisfy bond issue standards was abolished in 1990s and there is no need to gain a rating for issuing corporate bonds. However, it is required to get a rating when registering on the Tokyo Pro-bond market.

Credit Rating Agencies in Asia)³. These include the formulation of the common code of conduct of ACRAA, development of comparison of national ratings through default data study and implementation of better education of rating analysts, among others.

These international discussions on the CRAs outlined above started out of regret that the practices of the credit rating business and the close connection between the rating agencies and the users were one of the factors that contributed to the deepening of the global financial crisis and therefore the focus was targeted to restrict the excessive conducts of the financial intermediaries, mainly in the US and Europe. In that sense, it will not be appropriate to apply their outcomes across the board to the East Asia where the credit rating business is still in the early stage of development. Rather it would be more appropriate in Asia to explore the desirable Asian way of business conducts, concentrating on the fostering of the CRAs and improvement of regulation system and its environment.

³ Currently 30 CRAs of 13 economies including South Asia are members of the ACCRA.

(Reference) List of Domestic CRAs in East Asia

Country	Company name	ACRAA membership
Indonesia	Pefindo Credit Rating Indonesia	○
	PT ICRA Indonesia	○
	PT. Fitch Rating Indonesia	
Malaysia	Malaysian Rating Corporation Berhad (MARC)	○
	RAM Rating Services Bhd	○
Philippines	Philippine Rating Services Corporation (PhilRatings)	○
	Credit Rating and Investors Services Philippines, Inc.	
Singapore	Moody's Singapore PTE Ltd.	
	Standard and Poors International L.L.C.	
	Fitch Ratings Singapore Private Ltd.	
Thailand	TRIS Rating Co. Ltd.	○
	Fitch Thailand	
China, with the licence approved by the PBC ¹	Shanghai Brilliance Credit Rating & Investors Service Co., Ltd.	○
	Dagong Global Credit Rating Co., Ltd.	○
	China Chengxin International Credit Rating Co., Ltd.	○
	China Lianhe Credit Rating Co., Ltd.	○
	Golden Credit Rating International Co., Ltd.	
	Shanghai Far East Credit Rating Co., Ltd.	○
China, with the licence approved by the CSRC ²	Shanghai Brilliance Credit Rating & Investors Service Co., Ltd.	○
	Dagong Global Credit Rating Co., Ltd.	○
	China Chengxin Credit Rating Co., Ltd.	
	China Lianhe Credit Rating Co., Ltd.	
	Golden Credit Rating International Co., Ltd.	
	Pengyuan Credit Rating Co., Ltd.	
Hong Kong	Moody's Asia-Pacific Ltd.	
	Standard and Poors International L.L.C.	
	Fitch (Hong Kong) Ltd.	
Japan	Japan Credit Rating Agency,Ltd.	○
	Moody's Japan K.K.	
	Moody's SF Japan K.K.	
	Standard and Poor's Rating Japan K.K.	
	Rating and Investment Information, Inc	
	Fitch Rating Japan Limited	
	Nippon Standard and Poor's K.K.	
Korea	Korea Investors Service, Inc. (KIS)	○
	Korea Ratings Corporation (Korea Ratings)	○
	Nice Investors Service Co. Ltd. (NICE)	○
	Seoul Credit Rating & Information, Inc. (SCRI)	○

Notes: 1.PBC: the People's Bank of China

2.CSRC: the China Securities Regulatory Commission

(Source) Compiled by IIMA from company website, AsianBondsOnline and hearing from ACRAA members

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