FSB FINANCIAL STABILITY BOARD

Press release

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Financial Stability Board publishes principles to reduce reliance on CRA ratings

The Financial Stability Board (FSB) published today *Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings*.

The use (or "hard wiring") of CRA ratings in regulatory regimes for banks and other financial institutions has contributed significantly to mechanistic market reliance on ratings. This in turn is a cause of herding and cliff effects from CRA ratings changes that can amplify procyclicality and cause systemic disruption. But, more widely, the official "seal of approval" implied by the use CRA ratings in regulatory rules has contributed to an undesirable reduction in banks', institutional investors' and other market participants' own capacity for credit risk assessment and due diligence.

The goal of the principles is to reduce mechanistic reliance on ratings and to incentivise improvements in independent credit risk assessment and due diligence capacity. Banks, market participants and institutional investors should be expected to make their own credit assessments, and not rely solely or mechanistically on CRA ratings. The design of regulations and other official sector actions should support this. Accordingly, authorities should assess references to CRA ratings in laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness.

The principles aim to catalyse a significant change in existing practices. They cover the application of the broad objectives in five areas:

- prudential supervision of banks
- policies of investment managers and institutional investors
- central bank operations
- private sector margin requirements, and
- disclosure requirements for issuers of securities.

The FSB has asked standard setters and regulators to consider the next steps that could be taken to translate the principles into more specific policy actions to reduce reliance on CRA ratings in laws and regulations. It recognises that changes in market practices cannot happen overnight. This means incentivising a transition to a reduced reliance 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, and the particular circumstances of products, market participants and jurisdictions. Such actions have already been taken or are being considered by some international standard setters and in some jurisdictions. The FSB will monitor progress in this transition.

Notes to editors

The report issued today was endorsed by G20 Finance Ministers and Central Bank Governors at their meeting in Gyeongju, Korea, on 22-23 October.

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 is chaired by Mario Draghi, Governor of the Bank of Italy. 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.