FSB FINANCIAL STABILITY BOARD

Press release

Press enquiries:
+41 61 280 8001

press@bis.org

Ref no: 64/2013

29 August 2013

FSB publishes progress report and interim peer review report on credit rating agency ratings

The Financial Stability Board (FSB) published today a progress report on reducing reliance on, and strengthening the oversight of, credit rating agencies (CRAs). The progress report is accompanied by the interim peer review report on national implementation of the FSB *Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings*.

The progress report includes a summary of the main findings and recommendations of the peer review, describes ongoing work by standard-setting bodies to reduce references to CRA ratings in international standards, and provides an update on work by the International Organisation of Securities Commissions (IOSCO) to improve transparency and competition among CRAs.

The main points of **the progress report** are as follows:

- Authorities need to accelerate work to end the mechanistic reliance of regulatory regimes and of market participants on external ratings, which can lead to herd behaviour and cliff effects in market prices when downgrades occur.
- The FSB is taking forward its roadmap to reduce reliance on CRA ratings through a peer review of national authorities' actions to reduce reliance. The review aims to accelerate progress and assist national authorities in fulfilling their commitments under the roadmap.
- The interim peer review notes that jurisdictions have faced different starting positions from which to make reforms. The US has moved the furthest in removing hard-wiring of ratings, and the EU has also made significant progress. Progress in most other jurisdictions has been slower.
- Among existing international standards, the greatest use of CRA ratings is in the Basel framework. The Basel Committee for Banking Supervision has made proposals to reduce reliance in its securitisation framework and by mid-2014 will make proposals on reducing reliance within its standardised approach for capital requirements. The challenge is to identify credible alternative standards of creditworthiness.
- Market participants need to improve their own capacity to make their own credit assessments in order that they can safely reduce their reliance on CRA ratings. This too presents challenges and will take time.
- FSB members should disclose action plans, as agreed under the roadmap, that identify and prioritise further areas for changes in laws and regulations. These action

plans will be used in the second stage of the peer review to share lessons on the steps that can be taken by authorities to reduce references to CRA ratings in legislation and regulation and to promote strengthened credit assessment capabilities.

- IOSCO sees enhanced transparency as playing an important role in market competition and may enhance its transparency standards for CRAs as part of its ongoing revision of its CRA Code of Conduct. The FSB will continue to monitor whether further work is needed in this area beyond the revision of the Code.

The **interim peer review report** includes a structured stock-taking of references to CRA ratings in national authorities' laws and regulations and of actions taken and underway to reduce those references. A few FSB jurisdictions have not yet completed a stock-taking, and the peer review recommends that they do so by end-September 2013.

While recognising the progress made in implementing the *Principles*, the peer review has identified several areas where accelerated progress is needed, including that, FSB jurisdictions should:

- provide incentives to financial institutions to develop their own independent credit assessment processes;
- encourage or continue to enhance disclosures on financial institutions' internal credit risk assessment practices (drawing on guidance from standard-setting bodies where available).

The peer review has also identified a number of challenges that need to be addressed in order to make further progress in implementing the *Principles*. These include reducing undue reliance on CRA ratings in international standards as well as in private contracts or private sector investment decisions; identifying suitable alternative standards of creditworthiness; and addressing constraints in the development of internal risk assessment systems, particularly for smaller firms. The second stage of the peer review will analyse these challenges in more detail. The FSB intends to issue the final peer review report in early 2014.

Notes to editors

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. Standard setters and authorities should assess references to CRA ratings in standards, laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness. Banks, market participants and institutional investors should be expected to make their own credit assessments, and not rely solely or mechanistically on CRA ratings.

In response to the call of G20 Leaders in Los Cabos, the FSB published a roadmap in October 2012 with timelines to accelerate implementation of the *Principles*. 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.

As one of the steps to support the roadmap, the FSB is undertaking a thematic peer review. The peer review of the *Principles* is structured in two stages, the first of which – described in the interim report – comprises 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 interim report published today describes the findings and conclusions of the first stage of the peer review, including the key elements of the discussion in the FSB Standing Committee on Standards Implementation. 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.