

Brief Report on the Outcomes of the Seminar on “Domestic Credit Rating Agencies in Asia—Roles, Issues, and Challenges”

On the occasion of ADB’s 37th Annual Meeting in Jeju, Republic of Korea, ADB organized a seminar on “Domestic Credit Rating Agencies in Asia - Roles, Issues, and Challenges.” The speakers at the seminar were Suresh Menon, Executive Director of Rating Agency Malaysia Berhad; Kazumi Takemoto, Managing Director, Moody's Investors Service; Rajagopalan Ravimohan, Managing Director and CEO of Credit Rating Information Services of India Ltd.; Santiago F. Dumlao, Jr., President of Philippine Rating Services Corporation; Yasuhiro Harada, Executive Vice President of Rating and Investment Information, Inc., Japan; and Suk-In Kang, President, National Information and Credit Evaluation, Inc., Republic of Korea. Daikichi Momma, Director of the International Bureau of Japan's Ministry of Finance and Leo Mun Wai, Executive Director of the Monetary Authority of Singapore's External Department were the moderators for the seminar. Mr. Momma gave the opening remarks.

In his opening remarks, Mr. Momma pointed out that in order to develop a deep and well-functioning bond market, it is indispensable to have a high quality rating system in order to fill the information asymmetry between issuers and investors. However, he said, in Asia there still remain some issues before that is achieved. He said domestic credit rating agencies (DCRAs) are criticized to have softer ratings as compared to those of global CRAs, insufficient default data disclosure, and slow downgrading at the time of credit defaults, and lack comparability in credit ratings between countries that hinder cross border transactions and lack credibility. He said in order to facilitate cross border bond transactions in the region, comparability in credit ratings among different countries need to be achieved.

In his presentation, Mr. Menon discussed the key roles, opportunities, and challenges faced by DCRAs in Asia. He said established DCRAs assist in the formation of other DCRAs in the region since global CRAs generally do not enter local markets at the development stage. Moreover, as fees charged by global CRAs are much higher than DCRAs, the latter have a niche in servicing smaller issuers. DCRAs also play an invaluable role in developing nascent domestic bond markets. The increasing support and initiatives for developing these markets in Asia, as well as the new Basel Capital Accord requiring banks to use ratings from approved external credit assessment institutions, offer opportunities for DCRAs to expand beyond their national borders. The demand for regional ratings therefore will gain greater importance over time. In recognizing new opportunities and challenges, DCRAs need be proactive. Given these opportunities and competition from global CRAs, DCRAs, whose ratings are said to be not comparable across national borders, need to improve their institutional capacity to rate both domestic and foreign denominated bond issues and to enhance standards and credibility in general. Currently, the Association of Credit Rating Agencies in Asia (ACRAA), established in September 2001, serves as a platform for improving standards of DCRAs through organizing training workshops and compiling best practices in rating leading to harmonization of rating practices in the region. A further step towards improving standards is to form a regional CRA to rate Asian issuers.

Mr. Takemoto pointed out that DCRAs in Asia are perceived to have guaranteed rating revenue and rating coverage by regulatory mandates and/or monopoly position, a short history of rating record, lack of transparency, and lack of international recognition. To develop local credit markets, he said there is a need for growth of credit expertise among local professionals and presence of multiple rating agencies.

Mr. Ravimohan thought that there was a case for government to support rating agencies as they benefit the economy as a whole by expanding the savings pool, widening access to funding for smaller businesses, complimenting regulatory oversight, and providing an effective self-corrective tool for managements and businesses. The government's role is to create an enabling environment for the development of DCRAs by laying down policy and the framework within which market players operate, ensuring macroeconomic stability, setting up institutions, and designing market structure for healthy competition. He said these roles change with time as regulatory institutions are developed.

In his presentation, Mr. Dumlao said that Asia should strive for achieving harmonization of rating practices among DCRAs, i.e., achieving a degree of comparability across rating agencies in terms of rating methodology, rating criteria, definitions, benchmarks, and overall rating processes. He identified several obstacles to its achievement, including the lack of urgency on the part of rating agencies, different accounting standards and legal framework, varying business cultures and levels of domestic capital markets, and different attitudes of regulatory authorities. He said ACRAA helps in the harmonization process for credit rating agencies in Asia through its two basic recurring activities - training workshops and best practice dialogues. ACRAA has compiled a Compendium of Best Practices as an instrument of self-regulation and a Glossary of Rating-related terms is being prepared to standardize the meanings of key terms.

In his presentation, Mr. Harada emphasized the important role of CRAs in the development of securities markets as they provide intelligent evaluation of the markets' risks that tend to be complicated. Given the expansion of the structured finance market in Japan, Mr. Harada saw a significant and increasing role for DCRAs. Moreover, in the framework of the New Basel Capital Accord, he said CRAs will play an influential role as an external credit assessment institution especially in the measurement of credit risk of securitization instruments.

Mr. Kang said Korea's credit rating industry, despite its relatively short history, plays an important role in the Korean bond market. Since the introduction of the asset-backed securities markets in the aftermath of the Asian financial crisis, a broad range of securitization programs have been developed, emerging as a promising new market for the rating industry. Although the focus of the Korean CRAs has been in the domestic market, he said it is imperative to actively engage in strengthening the nascent regional bond market and their presence in Asia. A key challenge to be addressed in the successful development of the Asian bond market is establishing the credibility of local CRAs among Asia based investors.

Overall, there was consensus in the seminar that strong, credible domestic credit rating industry is crucial to Asia's bond market development. The seminar provided ADB with very useful inputs in pursuing one of its key agenda --- promoting bond market development in Asia.

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