MEDIA RELEASE

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

IOSCO/MR/20/2015

Madrid, 08 June 2015

IOSCO publishes good practices on reducing reliance on CRAs in Asset Management

The International Organization of Securities Commissions (IOSCO) today published its final report on *Good practices on reducing reliance on CRAs in Asset Management*, which provides a set of good practices for reducing over-reliance on external credit ratings in the asset management industry.

The report stresses the importance of asset managers having the appropriate expertise and processes in place to assess and manage the credit risk associated with their investment decisions. To help managers avoid over-reliance on external ratings, the report lists eight good practices that they may consider when resorting to external ratings.

In the report, IOSCO notes that the use of external ratings by asset managers is mainly demand-driven, as various forms of reliance on external credit ratings remain on the investor side. References to external credit ratings may derive from regulatory requirements or an investor's own internal rules. This may result in mechanistic reliance, which could trigger forced asset sales in the event of downgrades.

To address these concerns, IOSCO recommends considering potential ways to reduce possible investor overreliance on external ratings as a result of references in regulatory requirements. The good practices address national regulators, investment managers, and investors, where applicable. To identify these sound practices, IOSCO drew on the feedback received from

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various stakeholders, including asset managers and their representative trade bodies, institutional investors, and their associations as well as CRAs.

The importance of CRAs

CRAs play a prominent role in today's global financial markets. Asset managers often use their ratings as a factor in forming an opinion on the creditworthiness of a particular issuer before purchasing securities, selecting counterparties, or choosing the best collateral to secure transactions. For their part, investors often refer to CRA ratings when selecting investments or guiding asset managers on the basis of a tailored investment mandate.

The role of CRAs has come under regulatory scrutiny, mainly as a result of the over-reliance of market participants, including investment managers and institutional investors, on CRA ratings in their assessments of both financial instruments and issuers in the run-up to the 2007-2008 financial crisis.

In response to this concern, the Financial Stability Board (FSB) published in October 2010 its report on *Principles for Reducing Reliance on CRA Ratings*. The goal of these Principles is to end mechanistic reliance on ratings by banks, institutional investors, and other market participants. They concluded with a call for regulators and standard setters such as IOSCO to consider steps for translating the Principles into more specific policy action.

Sound Practices identified

1) Asset managers make their own determinations as to the credit quality of a financial instrument before investing and throughout the holding period.

2) Asset managers have the appropriate expertise and processes in place to perform credit risk assessment appropriate to the nature, scale and complexity of any investment strategy they implement and the type and proportion of debt instruments they invest in, and should refrain from investing in products / issuers when they do not have enough information to perform an appropriate credit risk assessment.

3) External credit ratings may form one element, among others, of the internal assessment process but do not constitute the sole factor supporting the credit analysis.

4) The manager's internal assessment process is regularly updated and applied consistently.

5) Where external credit ratings are used, asset managers understand the methodologies, parameters and the basis on which the opinion of a CRA was produced, and have adequate means and expertise to identify the limitations of the methodology and assumptions used to form that opinion.

6) Asset managers review their disclosures describing alternative sources of credit information in addition to external credit ratings and make available to investors, as appropriate, a brief summary description of their internal credit assessment process, including how external credit ratings may be used to complement or as part of the manager's own internal credit assessment methods.

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7) When assessing the credit quality of their counterparties or collateral, asset managers do not rely solely on external credit ratings and consider alternative quality parameters (e.g., liquidity, valuation, correlation, etc.).

8) Where external credit ratings are used, a downgrade does not automatically trigger the immediate sale of the asset. Should the manager/board decide to divest, the transaction is conducted within a timeframe that is in the best interests of the investors.

NOTES TO THE EDITORS

1. IOSCO is the leading international policy forum for securities regulators and is recognized as the global standard setter for securities regulation. The organization's membership regulates more than 95% of the world's securities markets in more than 115 jurisdictions and it continues to expand.

2. The IOSCO Board is the governing and standard-setting body of the International Organization of Securities Commissions (IOSCO). The Board is made up of 34 securities regulators. Mr Greg Medcraft, chairman of the Australian Securities and Investments Commission, is the chair of the IOSCO Board. The members of the IOSCO Board are the securities regulatory authorities of Australia, Belgium, Brazil, China, Egypt, France, Germany, Greece, Hong Kong, India, Italy, Japan, Kenya, Korea, Malaysia, Mexico, the Netherlands, Nigeria, Ontario, Pakistan, Peru, Quebec, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Thailand, Trinidad and Tobago, Turkey, United Kingdom and the United States.

3. The Growth and Emerging Markets Committee is the largest Committee within IOSCO, representing 75 per cent of the IOSCO membership. Mr. Ranjit Ajit Singh, Chairman, Securities

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Commission, Malaysia, and Vice Chair of the IOSCO Board, is the Chair of the GEM. The Committee endeavors to promote the development and greater efficiency of emerging securities and futures markets by establishing principles and minimum standards, providing training programs and technical assistance for members and facilitating the exchange of information and transfer of technology and expertise.

4. IOSCO aims through its permanent structures:

- to cooperate in developing, implementing and promoting adherence to internationally recognized and consistent standards of regulation, oversight and enforcement in order to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;
- to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and
- to exchange information at both global and regional levels on their respective experiences in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.

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