MEMO# 28189

June 16, 2014

IOSCO Releases Consultation Report on Reducing Reliance on Credit Rating Agencies

[28189]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 8-14
INTERNATIONAL COMMITTEE No. 17-14
INVESTMENT ADVISERS COMMITTEE No. 5-14
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 12-14
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 9-14
SEC RULES COMMITTEE No. 26-14
SMALL FUNDS COMMITTEE No. 15-14 RE: IOSCO RELEASES CONSULTATION REPORT ON REDUCING RELIANCE ON CREDIT RATING AGENCIES

On June 4, the International Organization of Securities Commissions ("IOSCO") published a consultation report (the "Report") titled "Good Practices on Reducing Reliance on CRAs in asset management." [1] The Report, prepared by IOSCO Committee 5 on Investment Management, seeks information about the views and practices of investment managers, institutional investors, and other interested parties, with a view to developing, later this year, a final set of good practices on reducing reliance on external credit ratings in the asset management industry.

The Report begins by noting that the role of credit rating agencies ("CRAs") came under regulatory scrutiny following market participants' overreliance on CRA ratings in their assessments of financial instruments and issuers in the run-up to the 2007–2008 financial crisis. In October 2010, the Financial Stability Board ("FSB") published its report titled "Principles for Reducing Reliance on CRA Ratings", [2] which was intended to reduce reliance on CRA ratings in standards, laws, and regulations. IOSCO sees its work in this area as complementing that of the FSB.

The Report discusses a number of related subjects, including the following:

- The nature of investment managers' internal credit assessments;
- The manner in which investment managers rely on external credit ratings to communicate the level of credit risk in their portfolios;
- The extent to which investors make use of CRAs' ratings in the investment guidelines

to which investment managers are subject;
- Investment managers’ knowledge of the methodologies that CRAs use in formulating their credit ratings;
- Investment managers’ disclosures about how they use external credit ratings;
- Investment managers’ use of external credit ratings in assessing guarantors and other potential providers of credit support;
- Investment managers’ use of external credit ratings in assessing the quality of counterparties and collateral;
- Funds’ and investors’ use of external credit ratings of funds; and
- The manner in which investment managers respond to external credit rating changes (particularly downgrades).

In connection with these topics, the Report describes current practices as IOSCO understands them, proposes a number of “possible good practices,” and then poses a series of questions to investment managers, investors, and CRAs. The feedback that IOSCO receives on this Report will inform its finalized good practices paper.

ICI intends to submit a comment letter in response to the Report, and we will be having a call with Committee members to discuss the Report on July 2 at 2 p.m. ET. If you are interested in participating in the call, please RSVP to Kiera Robinson at kiera.robinson@ici.org or (202) 326-5818 for the dial-in number and passcode.

Matthew Thornton
Assistant Counsel

endnotes

[1] Available at www.iosco.org/library/pubdocs/pdf/IOSCOPD442.pdf.

[2] Available at www.financialstabilityboard.org/publications/r_101027.pdf. The FSB believes that reducing reliance on CRA ratings will reduce the herding and cliff effects it believes result from CRA rating thresholds being hard-wired into laws, regulations and market practices.