

**MAS and ESMA's collaboration marks global efforts in
regulating credit rating agencies**

**Quotes from RMI Director, Prof. Duan Jin-Chuan
Thomson Reuters**

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The memorandum of understanding (MoU) signed last week between the Monetary Authority of Singapore (MAS) and the European Securities and Markets Authority (ESMA) is a step forward in global regulators' efforts to regulate credit rating agencies, experts have told Thomson Reuters. They said harmonisation of rules and mutual recognition of supervisory standards are signs of positive developments given the multi-jurisdictional nature of credit rating.

In a press released issued on March 16, the MAS said the MoU formalised supervisory cooperation between the two regulators, which would allow them to share information so that cross-border credit rating agencies operating in Singapore and in the European Union could be more effectively supervised. The MoU came on the back of ESMA's recent recognition of Singapore's credit rating agency regulatory framework, which it considered to be in line with the EU's credit rating agency regulations.

Harmonisation, mutual recognition

Professor Duan Jin-Chuan, director of the Risk Management Institute (RMI) in Singapore, said the collaboration between the MAS and ESMA made sense given that credit rating is multi-jurisdictional. "Any harmonisation of rules and mutual recognition of supervisory standards are a good development and a natural thing for them to do," he told Thomson Reuters.

Industry officials said the MoU essentially recognised that the MAS and ESMA were supervising credit rating agencies in the same way. They said mutual recognition of regulations and standards between the two regulators would reduce the amount of paperwork and simplify the approval process for rating agencies operating in Singapore and looking to enter the European market and vice versa, which would otherwise have been extensive.

An industry official familiar with the ESMA, but who declined to be named, told Thomson Reuters: "It's more a question of comparing procedure between regulators. Do you do it the way we do it? And if so, let's simplify the process. It's a waste of time to ask rating agencies to start from scratch if all the work has already been done.

"Some rating agencies operating in Malaysia or China may in the future decide to operate in Singapore. That's up to the MAS to approve them of course. If a rating agency is licensed to operate in Singapore, by virtue of this MoU, it will also have ESMA's approval to operate in the European market."

Under existing EU Credit Rating Agencies Regulation, credit rating agencies looking to operate in the European market would need ESMA's registration. "One way to get around that difficulty is that, if ESMA believes that local regulators have procedures, know-how and rules similar to [those of] ESMA, it is possible for the home regulator of that rating agency and ESMA to come up with an agreement that recognises each other's way of supervision," the industry official said.

He said ESMA is in the process of establishing a list of approved rating agencies, which will be published in April.

Regulation sets minimum standards

Duan, who is also Cycle and Carriage professor at the National University of Singapore, however, cautioned against putting high expectations on regulation to solve the problems that plagued credit rating agencies. Credit rating agencies came under criticism during the crisis for the way they operated and the methodologies they used, amongst others.

"While the collaboration between the MAS and ESMA makes sense, we can't expect such collaborations to solve the problems. Ultimately, you want to have high quality rating results. But you can't get high quality ratings simply through regulation," he said.

Duan said regulation, like the law, sets minimum standards, and crossing that line means that penalties will be imposed. "But saying that we should not expect too much from regulation or the law does not mean that we can ignore the law. The society functions under and/or above the law and a whole lot of other norms which govern our behaviour. Socially acceptable does not mean that it is not legally punishable, and legally acceptable does not mean that it is socially fine," he said.

The MAS's recently released Code of Conduct for Credit Rating Agencies has introduced new procedures, together with penalties for those who fail to adopt the code.

"Although the code is non-statutory, the regulator will determine whether rating agencies that fail to follow the code of conduct will have their licenses revoked. Once the license is revoked, it will be out of the business. It is good for the finance community to have some code of conduct; it sets some boundaries or some sort of recourse, so that regulators can go after them for licensing consideration. To some extent, the code of conduct is a deterrent," he said.

While noting that regulation and tightening of rules were good things to have, Duan said complying with regulation does not mean that reality gets reflected. "Business practices have already adopted some of the code of conduct at least on paper, yet we have seen so much trouble and non-compliance in essence. We cannot put too much faith on regulation or tightening of rules," he said.

"We can never count on regulation to give us high quality rating results. High quality results can only be driven by competition either for business motives or intellectual curiosity. That is why the RMI's Credit Research Initiatives is a scientific pursuit. We try to influence the world through our knowledge advancement and credit analytic technology. We are a public domain operator. We made it free for use — it's another way we influence the world."

Breaking the monopoly

Industry sources argued that long-standing competition among the three international rating agencies, Moody's, S&P and Fitch, have not necessarily motivated them to improve their business practices. Duan explained: "Certain competition is healthy. But we don't expect competition to always bring good thing out of it. Certain business practices and the regulatory framework for credit rating in the past have created a kind of competition in a distorted market. Because the nature of the credit rating market is information, if users pay for the ratings, they cannot share the information with other parties. That goes back to what I have said about conceptual foundation. It has to be a public good and some kind of knowledge infrastructure. Just like all scientific competition is not primarily for profit, they are either to satisfy curiosity or to pursue reputation."

One of the topics surrounding credit rating agencies among global regulators is to introduce new rating agencies to the international financial sector to compete with S&P, Moody's and Fitch. "At the moment, the three rating agencies have a quasi-monopoly of the credit rating market. The common feeling among global regulators is that they would like to see a bit of competition among the rating agencies and they would like to see new rating agencies come on stream with different methodology so that it adds diversification and sets new standards. This brings us back to the cause, that of the sub-prime crisis, when credit rating agencies did not do their job," the industry official told Thomson Reuters.

Industry experts said the MoU between the MAS and ESMA could be the start of more such efforts which would help the smaller or less well-known agencies become recognised in the global financial services sector. "For rating agencies to be well accepted by regulators and the investor community, they have to be quite international. It is fairly expensive to have an "international" status. For new rating agencies to be able to compete with the [three existing] established ones, regulators have to help them compete with their know-how," the industry official said.

According to the industry official, a small Portuguese credit rating agency is trying to make itself better known and recognised in the European financial market. "It is extremely important for rating agencies to bring value to the market. Anything that helps to regulate rating agencies in a harmonised way is helpful," he added.