

# Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



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Autoritatea Națională pentru  
Protectia Consumatorilor



## SPI Project on Credit Rating Agencies Development

### Project Strategy Meeting

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Romanian Banking Institute

SPI Romania Office

#### Participants:

##### *Project Management Group*

Doina Ionescu, Banc Post, Project Manager

##### *Project Working Group*

Bogdan Moinescu, Financial Stability Department, National Bank of Romania

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## MINUTES

### I. Project background

The SPI Secretariat has provided a background on the SPI project working groups' governance and activities. Likewise, a brief introduction has been made on the SPI project on credit rating agencies and its terms of reference.

While the initial project objective was to explore the development of local External Credit Assessment Institutions (ECAIs), the practical difficulties of setting up Basel II eligible rating agencies suggest that a more feasible approach would be to encourage the creation of domestic rating agencies able to carry out rating activities for listed companies, with the potential of further building their capacity to become ECAIs over time.

Therefore, the project objective is being modified to *prepare a set of draft regulations (and associated documentation) that will spell out the institutional, financial and organizational conditions under which local rating agencies could be licensed to carry out rating activities for listed companies. This documentation will include considerations on implementation constraints and criticalities, in order to allow for the further development of these rating agencies into local ECAIs, in conformity with the Basel II/CRD requirements.*

## II. Project working group discussions

**National Bank of Romania** (NBR) outlined its initiatives in the area of rating agencies. In this respect, the NBR stressed its interest in the development of credit rating agencies as External Credit Assessment Institutions – ECAIs in the Basel II context.

The NBR has performed a technical study on the opportunity of establishing an ECAI function within the central bank in the context where the Financial Stability Department has developed an advanced model for assessing the credit risk well exceeding the scoring function<sup>1</sup>. The study has been performed in the context of the twinning arrangement with Bank of France and Bank of Italy and is inspired by the example of Bank of France, which has been accepted to operate as ECAI.

The study is presenting an analysis of the pros and cons of this initiative, as well as of the requirements for the methodological tools, the infrastructure, and the organization of an ECAI. One of the main risks identified by the study refers to the crowding out effect on private local initiatives of establishing ECAIs that would be generated by the integration of such a function within the central bank.

The study has been analyzed by the NBR department and has been debated in the NBR Supervisory Council. The Supervisory Council has approved the continuation of the analysis in this area, but outlined that at present it would not be opportune to set up an ECAI within the central bank.

Regarding the regulatory framework, the general eligibility criteria for ECAIs have been stated in *NBR and National Securities Commission (NSC) Regulation no. 14/19/2006 regarding the treatment of credit risk by credit institutions and investment firms according to the standardized approach*. In broad terms, eligibility criteria for ECAIs refer to their objectivity, independence, international access/transparency, disclosure, resources, and credibility. The NBR Regulation Department is currently developing an ECAI evaluation procedure, based on the relevant CEBS guidelines.

The NBR representative has outlined the division of functions within the NBR with respect to the ECAIs: while regulation lies with the Regulation Department, the ECAIs will have to be agreed by the Supervision Department and the Financial Stability Department which has developed the models that could potentially support an ECAI function.

In terms of data availability for performing an ECAI function, it would be important to mention that the NBR does not dispose of adequate information for the time being (i.e. 7-10 years statistical time series). One practical solution to the data shortage would be overcome if banks would agree to put their data together in a common database.

**National Securities Commission** has outlined the distinct nature of the two sets of regulations pertaining to credit rating agencies:

- a) NSC regulation for allowing credit rating agencies to carry out rating activities for companies listed on the stock exchanges – this regulation has been drafted and it is

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<sup>1</sup> The model uses NBR Credit Register data, as well as data provided by the Ministry of Economy and Finance.

- currently undertaking a public consultation process. The regulation promotes a “soft assessment” of credit rating agencies which will not be supervised by the NSC;
- b) NBR-NSC regulation stating the ECAI evaluation procedure – this regulation is currently being drafted by the NBR in the application of the NBR-NSC Regulation no. 14/19/2006.

The NSC has outlined the need for the two regulations to be correlated as the ECAI regulation will most likely impose higher recognition standards than the one referring to regular rating activities for capital market purposes. Therefore, the NSC would like to wait for the NBR drafted regulation on ECAIs before issuing its own regulation on local rating activities for listed companies, in the assumption ECAI regulations will be issued shortly.

**Credit rating agencies** have outlined that a relatively large number of companies provide services in the area of “commercial information” and suggested that it would be important to also get their point of view. The local credit rating agencies analyze the commercial companies’ financial and non-financial information in order to develop the credit rating.

In particular, the credit rating agency represented has created a complex credit rating scoring model based on “financial scoring” (based on company financial data) and “soft scoring” (based on non-financial information) which produce together a “general scoring” for a particular company.

Regarding the access to information, the credit rating agency represented revealed that it is in practice confronted with a lack of relevant data and information. In this regard, the agency outlined that it has placed a request to access NBR Credit Register data, which has been refused due to the fact that the register can only provide information to those entities that also contribute with information (i.e. banks).

Also, from discussions with the NBR it resulted that the NBR could agree a scoring model proposed by a local credit rating agency which is a subsidiary of an international rating agency whose scoring model has been approved by another ESCB central bank (provided that the two models are identical).

**Banks** have also outlined that in relation to credit scoring they play a dual role: on the one hand banks can be assigned credit ratings, on the other hand they can use the ratings assigned to client companies in order to make a more informed credit assessment and to diminish the capital requirements.

In terms of the demand for rating, the banks representatives consider that there is little awareness on the benefits of obtaining a credit rating. This point was endorsed by the rating agencies representative who outlined that only large companies request to be rated, usually as a guarantee for their creditworthiness in relationship with external partners. At present, about 10 Romanian companies listed on the stock exchange are rated.

**Other issues raised** refer to the solicited versus the unsolicited rating. In this regard, the NSC has outlined the potential danger that unsolicited ratings could harm the image of listed companies. In this regard, it would be important to determine when it would be opportune to demand the approval of the respective companies in order to disclose assessments performed based on public data. Likewise, the ratings issued are likely to depend on the credibility of the rating agency. The project working group will further study this issue.

### III. Project next steps

The project working group has approved the TORs and the project objective. The project working group has approved the following work plan for the next period:

**Banks** – will prepare a presentation on the perceived benefits from using ratings issued by local ECAIs and on the foreseen implementation difficulties and possible ways to overcome them (by July 6);

**Credit Rating Agencies** – will provide the SPI Secretariat with contacts of other local agencies which should be consulted throughout the project (by June 25) and will provide feedback on the NSC draft regulation as well as on the perceived difficulties in complying with its requirements (by July 6); will also analyse the eligibility criteria for ECAIs proposed by NBR and will outline the implementation constraints (by July 13);

**NSC** – will provide the existing draft regulation for enabling local CRAs to carry out rating activities and any other relevant documentation, together with a brief presentation of the perceived drawbacks in issuing the regulation (by June 26); will get in touch with the NSC Basel II group representatives in order to announce the intention of having the ECAI regulation debated within the SPI project working group (by June 26);

**NBR Financial Stability Department** – will provide the project working group with an extract from the Financial Stability note with relevant information on the methodological and organizational requirement for ECAIs and any other relevant issues that could support the project working group in performing its analysis (by June 26);

**NBR Regulation Department** – will be asked to provide a brief presentation of the relevant Basel II/CRD requirements regarding the eligibility criteria for ECAIs, outlining the envisaged regulatory solutions for transposing the international standards into the domestic legislation (by June 29) and will be asked to provide an input of the NSC draft regulation on rating activities for listed companies (by July 6);

**SPI Secretariat** – will contact the Regulation Department and will ask it to contribute to the SPI project (by June 25); will contact other local credit rating agencies and will inform them about the project and ask for their feedback on relevant matters (by July 6); will contact the IFC in order to determine if it could support the project working group with a technical anchor (by June 29), and will prepare a) an intermediate paper based on the input received from the Financial Stability and the Regulation Departments (by June 29) and b) a centralized issues paper on the regulatory and implementation options, constraints and criticalities based on the input received from the project working group (by July 17).

### IV. Next project working group meeting

Depending on the relevant information availability, the next project working group meeting could be held in the week July 16-20.