

POSITION PAPER:

The Need for A Global Organization for All Stakeholders of Credit Ratings

Establish a Global Organization Dedicated to Clarifying and Advancing Credit Ratings

We believe that an appropriate initiative to restore credit ratings to their proper role is to establish a global organization exclusively focused on credit ratings activities. This organization would provide a universal voice and global platform for the advancement of professional credit risk opinions by independent and reputable credit rating agencies.

The mission statement of the organization is to provide a universal voice and global platform for the advancement of progressive and professional credit risk opinions by independent and reputable credit rating professionals.

The Role of Credit Ratings & Credit Rating Agencies (CRA's)

Modern financial markets stipulate that clear, valid and broadly communicated credit risk standards must be well known, well understood and reliably evident to all financial market participants.

We believe that these fundamentals have been compromise by greed, misuse of ratings, and a general disregard for rigorous application of risk management analysis and due diligence. As a result, restoration and maintenance of investor and public trust in credit ratings has become a primary challenge for financial markets and credit risk evaluation for the foreseeable future.

We believe that credit risk differentiation is and will continue to be a fundamental and significant requirement for global capital market order. Credit ratings are professional opinions and are part of the vocabulary for benchmarking and addressing the credit worthiness of the borrower, the lender, and the asset being financed by credit. Credit ratings of undoubted integrity are indispensable for a solution to the crisis in global financial markets.

Rationale: The Need for this Global Organization

Modern finance is defined as a vibrant, dynamic financial system at the center of vibrant, open and market-defined economic order. The 21st Century embraces the benefits of modern finance assisted by information technology, globalization, and up-to-date commercial practices and banking. Unfortunately, modern finance also features an increased reliance on the false sense of intellectual security provided by analytic and mathematical models. Modern finance is also characterized by the loss of time and distance due to modern transport, internet communications and open borders. In a smaller, faster, more technical world, modern finance needs

and uses a language and symbols to signal credit risk discrimination; credit ratings have come to provide just what the world market wanted. Thus our position that market order continues to need symbols and language of global quality ratings and professionals to develop and communicate these ratings.

Brief Description of a Credit Rating Organization

The prospective not-for-profit organization is intended to address three vital issues:

The most important is to be a scholar and advocate of “quality” credit ratings. To accomplish this, the organization will need to provide and promote expertise for credit risk discrimination, credit risk research, and financial literacy regarding credit and the proper use of credit ratings.

The second task is to validate and to affirm the integrity of the business models for creating and maintaining credit ratings.

The third is to be an administrator and policy warden for regulation and supervision of financial institutions that use and reference credit ratings.

The principal activities of the organization will be to:

1. Enhance and expand financial literacy and understanding of credit ratings
2. Develop and promote best practices for credit ratings
3. Establish core concepts and standards of credit rating quality
4. Catalogue and publish definitions, codes, and certifiable metrics of rating quality that recognize both local and global markets
5. Perform advocacy roles for the credit rating industry

What the Credit Rating Organization Will Not Do

The credit rating organization will not serve as a self-regulatory organization. The enterprise whose membership includes rating agencies and non-rating agencies (see membership, below) will operate to provide strong and decisive counsel. The organization will have no enforcement powers for inappropriate or inadequate credit rating practices. Nor will the organization sanction credit ratings judged by the membership to be misleading for credit risk discrimination or inferior to best practice. The organization will not interfere with the business or public policy practices of any member or non-member but will give public voice to debates of such practices when and as needed according to due diligence and good intellectual order. In addition, the organization will not be a marketing or promotional advocate of any specific credit rating agency business interest.

The organization will be a legitimate sounding board for credit rating topics and questions, but it will not deliver or confirm judgments of credit rating accuracy, methodology details, credit rating criteria completeness, or possible violations of inaccurate or inappropriate practices. The organization will not support or endorse specific credit rating business

models. The enterprise will not support members or non-members in civil or criminal legal suits, or political and partisan debates.

Anticipated Benefits of a Global Credit Rating Organization

The credit rating organization will provide a central and clarifying “voice” for the credit ratings industry and its professionals. The organization will be a recognized entity that investors, issuers of debt, intermediators, regulators, official policymakers, the media, and in fact all market participants can turn to as a representative authority for credit ratings services. The organization will seek to set and sharpen standards for credit risk discrimination without interfering with the right of market participants to judge credit worthiness based on best practice and available information.

A major benefit of this organization is expected to be the improved and more efficient communication of credit rating information with fewer mixed messages and less confusion regarding differences in credit ratings. Currently, the various credit rating symbols, as well as the criteria and/or methodologies for assessing the credit worthiness of entities, instruments, and asset classes are often confusing and market participants rely on the individual communications of the several credit rating agencies.

One central platform for credit rating information, as provided by a credit ratings organization, will be a vast improvement for all market interests including credit rating agencies. Ratings of specific financial vehicles, such as structured products and derivatives can be clearly communicated by the organization to the benefit of all market participants. Similarly, a less fractured view of the credit rating industry and the improved understanding of a suitable role for credit rating opinions will benefit all market stakeholders.

Membership of a Credit Rating Organization

Participants in a credit rating organization will be solicited from the ranks of existing credit rating agencies, from potential credit rating agencies, and from other entities and individuals who provide critical and sensitive guidance for the role and responsibilities of credit risk discrimination.

Local, regional and global credit rating agencies will be the core target for membership. Non-rating agency sponsors include

- All users of credit ratings
- Central authorities and official sector agents
- Regulators and supervisors of financial institutions
- Financial and general media
- Judiciary services at all levels of society around the globe
- Academic interests and institutions
- Non-rating agency enterprises engaged in
 - Public policy
 - Private and public commerce
 - Research and information services
 - Non-governmental organizations and institutions

Reasons for credit rating agencies to participate and to become a founding member

Credit rating agencies will seek to become a member of this organization in order to more fully and completely address the increasing call for explanations of their ratings. Agencies will also join to explain their methodologies and their selection of criteria for ratings of counter parties, obligors and entities. The organization will also enable agencies to meet the increasing demand to explain not only the rating but also the context and assumptions for specific ratings or changes in ratings.

There is damage at this time to credit rating agency reputations following the widespread degradation of structured finance and financial institutions credit ratings. Corrective response to reputation damage is not easily addressed by the business interest of a single credit rating agency. No amount of explanation and apology adequately addresses the complex issues currently facing all credit rating agencies.

The collective and collaborative voice of the credit rating industry can offer better efforts to repair damaged reputations and may offer additional solutions to legal liabilities by better defining the proper role for credit ratings and the research behind such symbols of risk opinions. Changes to and better standards for those rating practices guilty of past conflict need independent and authoritative endorsement that is not available from credible sources outside of the professional and academic credit risk discrimination community. This organization will provide such service and voice to all credit rating agencies and all enterprises that wish to compete and contribute to the profession.

Reasons for other stakeholders that use credit ratings to participate

Membership by investors is likely due to the key role credit ratings have and will continue to have as benchmarks of credit risk levels, particularly since investors must provide their own due diligence for credit risk discrimination with respect to fiduciary and financial management responsibilities. Winning returns on risk suggest that investors must and will take an active role in the oversight and practices of credit rating agencies' creation and maintenance of credit ratings.

Modern finance presents a challenge for investors to keep up with innovations, entrepreneurial motivations - the key catalysts for economic growth. Since credit ratings capture all of these concerns, the role and participation of investors in this global organization is obvious and apparent.

Credit rating agencies provide a division of labor that allows credit discrimination to be done economically aside from the investment and lending business. But credit discrimination requires the constant input and attention of investors and thus this organization is an appealing utility for investors' support. We expect that this appeal will increase as the techniques of risk management expand the need and use of scenario

building, stress testing, and the quantitative index-tool building to facilitate price discovery for credit risks in an increasingly global market for money and capital.

Issuers or those interests that seek quality credit ratings in order to advertise the condition and status of their credit worthiness will also find this organization of interest. Major, frequent, and sizeable credit capital-raising entities have a primary interest in the quality and capability of credit rating agencies. The issuers' purchase of credit ratings will continue to be a viable business model even if regulations mandate restrictions and conditions on the selling of ratings to issuers. This is so because credit ratings are essential components for raising debt in national and global markets. Standards and codes for disclosure are the bedrock of credit rating agency services and all issuers of debt will remain an important part of the chorus for what and how disclosures will evolve relative to credit risk discrimination. Thus we expect issuer interests – separate from investors and from agent banks or intermediators – to seek a strong participation in the credit rating organization.

Finally, intermediators - those enterprises that help raise credit, that help invest in credit assets, or that process and have custody over credit raising or credit investing – are likely sponsors and members of this organization. Credit ratings in fact are facilitators and language markers for the flow of capital in credit channels where intermediators deliver business results. We expect that as a clearer voice and stronger message for credit risk discrimination evolves from this global organization for credit ratings, intermediators will be keen to participate. Financial media and official sector authorities will also join in the need to expand and explore the objectives of this organization as they are, in fact, a type of “intermediator” for the public good and public trust.

Funding: Initial and sustaining

Initial funding for this organization must be sourced from a diverse portfolio of stakeholder interests. Credit rating agencies as a group will be restricted to no more than fifty percent of the total initial funding. Modest capital contributions from nine to fifteen non-rating agency sources will provide 50% or more start up capital; credit rating agencies in total can match these funds.

After the initial funding, establishment of a formal charter, governance organization, rules for membership criteria, an operating budget, and other start up issues will be addressed. Sustaining capital will come from membership fees, advisory and research services contracts, and employment charters for training, certification and professional development activities. Permanent staff for this organization will be appropriately literate in credit rating endeavors and their business models. The staff need not be exceptionally large or entrepreneurial. Models for funding of this organization are most likely found in the non-profit corporate and academic communities.

CREDIT RATING ORGANIZATION

THE PROPOSAL:

Establish a global organization for all stakeholders in credit rating activities to restore and promote confidence and trust in credit ratings

EXPLANATION & BACKGROUND

- I. Credit risk differentiation is a fundamental, significant requirement for global capital market order
- II. Modern global financial markets demand simple, consistent, broadly understood and communicated signals of credit risk standards (credit ratings)
- III. Recent loss of trust in credit ratings is a major challenge and barrier to financial market recovery

CREDIT RATING STAKEHOLDERS

Trustworthy credit ratings are professional opinions used by four stakeholders in the capital markets:

1. Investors and lenders
2. Borrowers and issuers of credit instruments
3. Credit intermediators and agents
4. Credit rating agencies

CREDIT RATING CONCERNS

Standards and practices used to assign credit ratings must be transparent, independent and objective for credit ratings to regain and maintain the trust and confidence of investors and the public

All stakeholders need a voice and venue for their interests to be known, understood and addressed

There is a need for a global organization that will enable stakeholders to discuss standards and practices related to credit ratings

DESCRIPTION OF THE CREDIT RATING ORGANIZATION

A US 501c6 not-for-profit business association

Governance will be established with a
Non-Executive Chairman of an Advisory Board

A 10-15 member Advisory Board representing all
stakeholders

An Executive Managing Director

Two Operating Divisions with separate heads:
Credit Rating Industry Initiatives
Credit Rating Best Practices

THE ORGANIZATION WILL ADDRESS FIVE IMPORTANT ISSUES

1. Support rigorous, disciplined approach to credit ratings by
 - Promoting financial literacy regarding credit and the proper use of credit ratings
 - Discussing best practices for credit ratings
 - Facilitating credit risk research
 - Examining applications of ratings to public policy issues
2. Manage potential conflict of interests among stakeholders of credit ratings
3. Encourage self-regulation efforts by all stakeholders
4. Represent the conflicts and interests of credit ratings as appropriate with policymakers and regulators
5. Represent the common interests of credit ratings with the media and public opinion

WHAT THE ORGANIZATION WILL NOT DO

The organization is *not* intended:

- To be a regulatory organization
- To have examination or enforcement powers for inappropriate or inadequate credit rating practices
- To interfere with the business or public policy practices of any member or non-member
- To deliver or confirm judgments of credit rating performance and quality
- To support or endorse specific credit rating business models

BENEFITS OF A CREDIT RATING ORGANIZATION

The organization will provide a forum and voice for all stakeholders to:

- Work together to restore respect for and to promote wider understanding of credit ratings
- Sharpen standards for credit risk discrimination
- Improve and more efficient communicate credit rating information and diffusion of best practices

SUGGESTED MEMBERSHIP

Existing credit rating agencies such as

- Standard & Poor's
- Moody's Investors Service
- Fitch Ratings
- A.M. Best
- R & I Ratings of Japan
- Japan Credit Ratings
- DBRS Ltd

Recent and new-entrant credit rating agencies such as

- Rapid Ratings
- Egan-Jones Ratings
- LACE
- RealPoint Ratings

SUGGESTED MEMBERSHIP

Key Users of Credit Ratings, such as

- Buy-side portfolio managers and analysts
- Sell-side credit research and advisory teams
- Derivatives specialists, investors, traders and custodians
- Regulators and supervisors of financial institutions
- Auditor and accounting enterprises and consultants
- Legal firms
- Academic institutions and interests
- Financial and general media addressing credit risk topics

Other Users of Credit Ratings, such as

- Public policymakers
- Private and public commercial interests
- Research and information services
- Non-government organizations and institutions

FUNDING: INITIAL & SUSTAINING

A. Start-up or initial funding sourced from diverse stakeholder interests

Credit rating agencies on a combined basis cannot have a controlling representation on any board of the organization or control through funding support

Diverse stakeholders (7-15) expected to provide 50% or more initial funds

Prior to ongoing operations of the organization, the following are to be set

- Formal charter
- Governance structure
- Rules and categories for Membership
- Operating Budgets
- Staffing guidelines/assignments, all start up issues

B. Membership and fees are expected to sustain ongoing operations and development of the organization

Additional recurring revenue for sustaining operations is to come from advisory and research services contracts, credit rating research training, global certification and professional development activities

Lobbying and political action initiatives will be addressed according to the goals, ambitions, and determinations of the membership