



Bangko Sentral ng Pilipinas

Circular No. 404
Series of 2003

Pursuant to Monetary Board Resolution No. 1257, dated 28 August 2003, the following rules and regulations shall govern the recognition and derecognition of domestic credit rating agencies for bank supervisory purposes:

Section 1. STATEMENT OF POLICY

The introduction in the financial market of new and innovative products create increasing demand for and reliance on credit rating agencies (CRAs) by the industry players and regulators as well. As a matter of policy, the Bangko Sentral ng Pilipinas (BSP) wants to ensure that the reliance on credit ratings is not misplaced. Towards this end, the following rules and regulations that shall govern the recognition/derecognition of domestic CRAs for bank supervisory purposes are hereby prescribed:

Section 2. MINIMUM ELIGIBILITY CRITERIA

Only ratings issued by CRAs recognized by the BSP shall be considered for BSP bank supervisory purposes. The BSP, through the Monetary Board, may officially recognize a credit rating agency upon satisfaction of the following requirements:

A. *Organizational Structure*

1. A domestic CRA must be a duly registered company under the Securities and Exchange Commission (SEC); and
2. A domestic CRA must have at least five (5) years track record in the issuance of reliable and credible ratings. In the case of new entrants, a probationary status may be granted: *Provided*, That the CRA employs professional analytical staff with experience in the credit rating business.

B. *Resources*

Human Resources

1. The size and quality of the CRA's professional analytical staff must have the capability to thoroughly and competently evaluate the assessed/rated entity's creditworthiness;

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2. The size of the CRA's professional analytical staff must be sufficient to allow substantial on-going contact with senior management and operational levels of assessed/rated entities as a routine component of the surveillance process;
3. The CRA shall establish a Rating Committee composed of adequately qualified and knowledgeable individuals in the rating business, majority of whom must have at least five (5) years experience in credit rating business;
4. The directors of the CRA must possess a high degree of competency equipped with the appropriate education and relevant experience in the rating business;
5. The directors, officers, members of the rating committee and professional analytical staff of the CRA have not at any time been convicted of any offense involving moral turpitude or violation of the Securities Regulation Code; and
6. The directors, officers, members of the rating committee and professional analytical staff of the CRA are not currently involved as a defendant in any litigation connected with violations of the Securities Regulation Code nor included in the BSP watchlist.

Financial resources

1. The CRA must have the financial capability to invest in the necessary technological infrastructure to ensure speedy acquisition and processing of data/information and timely release of reliable and credible ratings; and
2. The CRA must have financial independence that will allow it to operate free from economic and political pressures.

C. Objectivity

1. The CRA must use a rigorous and systematic assessment methodology that has been established for at least one year; however, a three-year period is preferable;
2. The assessment methodology of the CRA must be based both on qualitative and quantitative approaches; and

3. The CRA must use an assessment methodology that is subject to on-going review and is responsive to changes in the operations of assessed/rated entities.

D. *Independence*

1. The CRA must be free from control of and undue influence by the entities it assesses/rates;
2. The assessment process must be free from ownership pressures to allow management to exercise independent professional judgement;
3. Persons directly involved in the assessment process of the CRA are free from conflicts of interest with assessed/rated entities, and
4. The CRA does not assess/rate an associate entity.

E. *Transparency*

1. A general statement of the assessment methodology used by the CRA should be publicly available;
2. The CRA shall disseminate to the public thru a well-circularized publication, all assigned ratings disclosing whether the rating issued is solicited or unsolicited;
3. The rationale of ratings issued and risk factors considered in the assessment should be made available to the public;
4. The ratings issued by the CRA should be available both to domestic and foreign institutions with legitimate interest; and
5. Publication of changes in ratings together with the basis for the change should be done on a timely basis.

F. *Disclosure Requirements*

Qualitative Disclosures

1. Definition of ratings along with corresponding symbols;
2. Definition of what constitutes a default, time horizon within which a default is considered and measure of loss given a default; and

3. Material changes within the CRA (i.e., changes in management or organizational structure, rating personnel, modifications of rating practices, financial deterioration) that may affect its ability to provide reliable and credible ratings.

Quantitative Disclosures

1. Actual default rates experienced in each rating category; and
2. Rating transitions of assessed/rated entities over time (i.e., likelihood of an AAA credit rating transiting to AA etc. over time).

G. *Credibility*

1. The CRA must have a general reputation of high standards of integrity and fairness in dealing with its clients and conducts its business in an ethical manner;
2. The CRA is generally accepted by predominant users in the market (i.e., issuers, investors, bankers, financial institutions, securities traders); and
3. The CRA must carry out its rating activities with due diligence to ensure ratings are fair and appropriate.

For purposes of this circular, a subsidiary refers to a corporation, more than fifty percent (50%) of the voting stock of which is owned or controlled directly or indirectly by the CRA while an affiliate refers to a corporation, not more than fifty percent (50%) but not less than ten percent (10%) of the voting stock of which is owned or controlled directly or indirectly by the CRA.

"Control" exists when the parent owns directly or indirectly through subsidiaries more than one half of the voting power of an enterprise unless, in exceptional circumstance, it can be clearly demonstrated that such ownership does not constitute control. Control may also exist even when ownership is one half or less of the voting power of an enterprise when there is:

1. *power over more than one half of the voting rights by virtue of an agreement with other stockholders;*
2. *power to govern the financial and operating policies of the enterprise under a statute or an agreement;*
3. *power to appoint or remove the majority of the members of the board of directors or equivalent governing body;*

4. power to cast the majority votes at meetings of the board of directors or equivalent governing body; or
5. any other arrangement similar to any of the above.

H. Internal Compliance Procedures

1. The CRA must have the necessary internal procedures to prevent misuse or unauthorized disclosure of confidential/non-public information; and
2. The CRA must have rules and regulations that prevent insider trading and other conflict of interest situations.

Section 3. PRE-QUALIFICATION REQUIREMENTS

The application of a domestic CRA for BSP recognition shall be submitted to the Supervision and Examination Sector (SES) of the BSP together with the following information/documents:

A. An undertaking:

1. That the CRA shall comply with regulations, directives and instructions which the BSP or other regulatory agency/body may issue from time to time; and
2. That the CRA shall notify the BSP in writing of any material changes within the organization (i.e., changes in management or organizational structure, rating personnel, modifications of its rating practices, financial deterioration) that may affect its ability to provide reliable and credible ratings.

B. Other documents/information:

1. Brief history of the CRA, major rating activities handled including information on the name of the client, type of instruments rated, size and year of issue;
2. Audited financial statements for the past three (3) years and such other information as the Monetary Board may consider necessary for selection purposes;
3. For new entrants, employment of professional analytical staff with experience in the credit rating business;

4. List of major stockholders/partners (owning at least 10% of the voting stocks of the CRA directly or along with relatives within the 1st degree of consanguinity or affinity);
5. List of directors, officers, members of the rating committee and professional analytical staff of the CRA; including their qualifications, experience related to rating activities, directorship and shareholdings in the CRA and in other companies, if any;
6. List of subsidiaries and affiliates including their line of business and the nature of interest of the CRA in these companies;
7. Details of the denial of a previous request for recognition, if any (i.e., application date, date of denial, reason for denial etc.); and
8. Details of all settled and pending litigations connected with the securities market against the CRA, its directors, officers, stockholders, members of the rating committee and professional analytical staff, if any.

Section 4. INCLUSION IN BSP LIST

The BSP will regularly circularize to all banks and non-bank financial institutions an updated list of recognized CRAs. The BSP, however, shall not be liable for any damage or loss that may arise from its recognition of CRAs to be engaged by users.

Section 5. DERECOGNITION OF CREDIT RATING AGENCIES

A. Grounds for Derecognition

Credit rating agencies may be derecognized from the list of BSP recognized CRAs under the following circumstances:

1. Failure to maintain compliance with the requirements under Section 2 hereof or any willful misrepresentation in the information/documents required under Section 3 hereof;
2. Involvement in illegal activities such as ratings blackmail; creation of a false market or insider trading; divulging any confidential information about a client without prior consent to a third party without legitimate interest; indulging in unfair competition (i.e., luring clients of another rating agency by assuring higher ratings etc.); and

3. Any violations of applicable laws, rules and regulations.

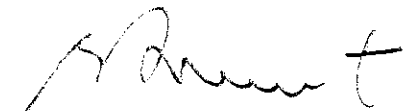
B. Procedure for Derecognition

A CRA shall only be derecognized upon prior notice and after being given the opportunity to defend itself.

Section 6. EFFECTIVITY

This Circular shall take effect after fifteen (15) days following its publication either in the Official Gazette or in any newspaper of general circulation.

FOR THE MONETARY BOARD:



RAFAEL B. BUENAVENTURA
Governor

Sept. 9, 2003