Comments on Daekeun Park and Changyong Rhee's paper "Building infrastructure for the Asian bond markets: settlement and credit rating"

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I shall limit my remarks to Section III of Park and Rhee's paper.

The authors conclude by arguing that "harmonisation" of local and global credit rating agencies is necessary to develop an Asian bond market. If what the authors mean is constraining competition between and the independence of credit rating agencies, I disagree. While the authors reject, rightfully, going down the route of government-supported rating agencies, they do not adequately appreciate how global agencies function or their role in the market. From an Asian-centric point of view, the authors' basic gripe is that global credit rating agencies are ignorant of local conditions, implying that they currently lack and will never have the capability to deliver accurate and objective rating opinions on local currency bond issuers. Their argument is convoluted, however, and does not appreciate that factors that affect credit fundamentals tend to be universal. The authors should have stuck more closely to the solution they cite in the opening paragraph of the subsection "The need for a regional credit rating agency". That is, "[t]he simplest means to meet this need would be to utilise global credit rating agencies, rather than establish a new regional institution". To which I would add, use global agencies along with competitive local agencies.

The fact is that global rating agencies are already increasingly expanding ratings in local markets, in Asia and elsewhere, employing local staff along with experienced staff from their home offices. Expansion includes assigning ratings on an agency's global scale, and also rating local corporations on country-specific rating scales. Moody's has ownership stakes in local rating agency affiliates that use indigenous rating scales. Moody's also uses national scale ratings where it does not have affiliates so as to fit into local credit rating systems. A national scale does not necessarily convey the same information as Moody's global scale rating symbols - the probability and expected severity of default. Rather, national rating scales are essentially ordinal, and issuers are notched down from the best issuer (Aaa by definition), providing a relative ranking of creditworthiness. Local rating scales are not as powerful as a rating agency's global scale. One important reason for such local scales is that capital market regulators in many emerging market countries require that a corporation receive an investment grade rating in order to issue. Therefore, regulators themselves have historically limited the universe of ratings. Thus, the national authorities themselves restrict the downward range of ratings on the part of either a local or a global rating agency, and foster a concentrated distribution of relatively high ratings.

Another mistaken notion of the authors is that global rating scales are not suitable for emerging markets. The authors claim that because the sovereign ratings for emerging market sovereigns are lower than in advanced economies (as laid out in Table 8), emerging market corporations are destined to have ratings concentrated in lower rating levels. This is not necessarily so, but to the extent that it is so, it reflects an assessment of credit fundamentals, not rating methodology biases. The fact is that the sovereign defaults in recent history (starting with Russia in 1998) occurred with non-investment grade emerging market government bonds (at the time), not investment grade rated government bonds. So the global rating scale functions as intended. The table lists foreign currency government ratings, but Moody's rating practice allows in select cases a corporation to pierce the foreign currency rating of the government. This happens mostly in countries that are assigned low ratings. Moreover, Moody's does not constrain the local currency ratings of fundamentally strong corporations by the local currency rating of the government (because the possibility of the imposition of foreign exchange controls is moot for local currency obligations).

Credit rating agencies in the United States developed in an environment of competition. I do not think that the authors' stress on "harmonisation" and coordination "in building a common credit rating system" captures the essence of how rating agencies have contributed to the efficiency of markets. The credit rating industry has its roots in the Anglo-Saxon tradition of free speech and constitutional guarantees of freedom of the press. Credit rating agencies exist in a publishing culture that values objectivity, accuracy and attentiveness to investor needs. A rating agency sells its judgments in a competitive marketplace that rewards credibility, and an agency accepts the reality that market forces will punish bad performance. Recently, in the United States, the number of rating agencies recognised by the market regulator increased to four from three, in an effort to heighten competition and accuracy, but not to foster harmonisation. A danger in the authors' prescription is that rating agencies might be appropriated either implicitly or explicitly by governmental authorities. In this event, companies would be buying a licence to issue bonds, rather than buying the credibility of a credit rating agency's opinion. Investor confidence would be sacrificed, along with efficiency in allocating capital and pricing risk into credit decisions. Rather, the authors should urge an improvement in accounting and disclosure practices of issuers in Asian bond markets - just like efforts under way in the US capital market at present.