



*Insight beyond the rating.*

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## Ratings are Opinions that are Useful as a Supplementary Risk Tool

Credit ratings are referenced or used in a wide variety of areas including regulatory capital requirements, financial securities legislation, and public and private investment mandates and policies. At the heart of this widespread use is the lack of viable, tested alternatives.

New securities are always being created, and there is a need for someone to put them on a level playing field for creditworthiness purposes.

Market-based tools of creditworthiness are more rapid measures that reflect immediate market sentiment. But in addition to point-in-time price information, investors and regulators need methods to measure the amount of risk that regulated financial entities take. Using non-credit rating agency opinions simply shifts the burden of providing independent credit assessments to a less regulated market and may introduce untested and highly volatile swings in the capitalization of companies in the financial sector. And a more refined differentiation of credit worthiness may only be achievable at the expense of greater implementation burden.

DBRS believes that credit ratings continue to be important to bondholders and other capital market participants. However, ratings should be used as a supplementary or complementary risk metric and information tool in investment and other decision-making.

By definition, a credit rating is an opinion that reflects the future creditworthiness of an issuer, a security or an obligation. A rating is not a statement of fact or a professional judgment. It is not a recommendation to buy a security, it is not investment advice, it is not an advertisement or an offer to buy or sell a security.

As an opinion of creditworthiness, credit rating agencies (CRAs) contribute to market efficiency by providing the market with an informed third party view about issuers and securities. CRAs communicate objective views and opinions concerning capital market developments and changes in the larger economy which may affect industries and individual companies. Ratings enhance investor understanding of risks, and provide a common language to communicate credit risk to the market. Indices and portfolio descriptions are examples of two uses of ratings that effectively contribute to investor understanding.

In their October 2010 Principles for Reducing Reliance on CRA Ratings, the Financial Stability Board recognized that “CRAs play an important role and their ratings can appropriately be used as an input to firms’ own judgement as part of internal credit assessment processes.”

Completely eliminating any reference to external ratings in regulatory capital frameworks is not a realistic solution in the absence of alternative measures of credit. The Basel bank sector proposals over the last couple of years have recognized this.



The December 2009 Basel proposals recognized that using credit ratings for capital purposes provide “a relatively standardized, harmonized, easy to understand, independent (third party) measure that generally reflects the credit quality of a counterparty, issuer or investment product.” The proposals also stated “that removal of external ratings from the Basel II framework could raise additional issues for determining regulatory capital requirements.”

The Basel Committee’s June 2010 revisions to its market risk framework continue to permit banking organizations to use credit ratings, and the recent Basel III proposals also reference credit ratings.

Financial regulation is converging around the world. This includes new and additional regulation for credit rating agencies. Where formal regulation and oversight is established, it is not inconsistent nor inappropriate for ratings to continue to be referenced and used. Rather, a balanced use of ratings is critical to the functioning of capital markets. Due to the global nature of ratings, removing ratings from use in one jurisdiction puts that jurisdiction and its regulators, investors and other participants at a comparative disadvantage in the global marketplace.

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