

CCMS 12th Annual Senior Policy Level Seminar

Credit Rating Agencies – Lessons learnt in Subprime Crisis & Role in Caribbean Mortgage Markets

May 02, 2008

Arjoon Harripaul, HEAD – Ratings

Caribbean Information & Credit Rating Services Limited

Presentation Structure



- ❑ Who is to be blamed for the subprime crisis?
- ❑ Criticisms leveled at Credit Rating Agencies (CRAs)
- ❑ CRAs defense
- ❑ Some Suggested Remedies
- ❑ Role of CRAs in Mortgage Markets

Who is to be blamed?



- There is no single entity or individual to point the finger at.
- Instead, this crisis is a collective creation of:
 - Regulators, including the Fed
 - Homeowners
 - Lenders
 - Underwriters
 - Investors
 - *Credit Rating Agencies (CRAs)*

Who is to be blamed?



- CRAs are neither the only, nor the main culprits.
- Entire mortgage industry lapsed:
 - **Buyers** lied about their incomes to qualify for loans
 - **Brokers** accepted buyers with checkered credit histories
 - **Investors** bought bonds in the secondary market without reference to risk

- The increase in demand for Ratings services lead to a “race to the bottom”.
- Benefited from too much official protection.
- Capitulated to the conflict of interest inherent in the business model.
- Collaborated with underwriters to ensure that structured securities got high enough ratings
- Too slow in warning investors about problem; downgrades started only in April 2007 although crisis loomed since 2006.

- Outright rejection of the notion that they should have been more vigilant.
- Ratings are designed to measure probability of default not to predict market prices of securities.
- Ratings are not a buy or sell recommendation.
- Long-term record is good; average 5-yr default rate for investment grade structured securities is less than 1%.
- The occurrence of a low-probability event.
- CRAs analysts operate on an aggregate basis and have no access to individual borrowers' files.

Some Suggested Remedies



- Create more CRAs
- More transparent and improve monitoring
- Remove journalistic privilege. Make CRAs legally liable for their opinions.
- Change the business model – someone other than issuers pay. Government perhaps.
- Make regulations less dependent on ratings
- Distinguish structured product ratings from corporate ratings.

Official Responses



- The US SEC introduced rules for CRAs in June 2007.
- Complete review of IOSCO's Code of Conduct Fundamentals for CRAs
- The European Commission
 - to review the current Voluntary Code used by CRAs and may propose new legislation in 2008.

Role of CRAs in Mortgage Markets



- Facilitates Structured Financing Alternatives, e.g. MBS
 - Benefits for Issuer/Borrower
 - Provides more structuring choices
 - Allows smaller institutions to access capital markets
 - Unlocks liquidity
 - Increase revenue without increasing capital

Role of CRAs in Mortgage Markets



- Benefits for Investor/Lender
 - More investment choices
 - Instruments can be customised to meet specific investment requirements
 - Diversifies risks in portfolio within the same geographical domain

Role of CRAs in Mortgage Markets



- Benefits for Market/System
 - Makes markets wider/deeper/diverse
 - Attract more participants
 - Reallocation in the savings pool
- Alternative financing mechanisms & instruments are the hallmark of developed capital markets.
- There are many opportunities in Caribbean Mortgage Markets today which can leverage on MBS.

THANK YOU

**Caribbean Information & Credit
Rating Services Limited**

info@caricris.com / www.caricris.com

Tel: (868) 627-8879

Fax: (868) 625-8871