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국제학석사학위논문

Bond Market Development in Asia
: Comparison of supervisory and regulatory reform on
Credit Rating Agency

아시아 채권시장 발전
: 아시아와 유럽의 신용평가기구 규제감독 변화비교

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국제학과국제지역학전공

임 근 영

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지도교수 이영섭

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국제학과 국제지역학전공
임근영

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위원장

문우식



(인)

부위원장

정영록



(인)

위원

이영섭



(인)

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Abstract

Bond Market Development in Asia

: Comparison of supervisory and regulatory reform on Credit Rating Agency

Keunyoung Lim

International Area Studies Major
Graduate School of International Studies
Seoul National University

When Asian Bond Market Initiatives (ABMI) was launched, development of local and rating credit rating agencies (CRA) were assigned to one of the six working groups. In order to achieve regional cooperation on the development of Asian bond market, enhancing the rating system and the strengthening the role of CRA was recognized as major issue by ASEAN+3 in 2003. Although there had been continuous studies and suggestion for having harmonized CRA system in Asia, growing concerns over the overall progress in the ABMI was recognized. ASEAN+3 proposed for the further development of well functioning bond market to meet increased regional investment. After the ABMI introduced a new road map in 2010, existing working groups were re-organized to four different Task Force groups and ASEAN+3 Bond Market

Forum (ABMF) was established under the task force 3 focusing on standardization of market practices and harmonization of regulations. Achieving harmonization on regulation not only requires cooperative effort by market participants and finance ministers, but also requires national authorities to carry out the measures. Unless national authorities actively participate into implementation of harmonized standard or regulation, issues addressed by AMBI cannot efficiently apply to domestic regulation.

This paper examines implementation of CRA regulation supervision in the EU and Asia. Most CRAs were not properly regulated until the recently and voluntary implementation of international standard was considered as enough measure. After the global financial crisis, issues related to CRA regulation received considerable attention by major countries. The most significant changes of institutional arrangement change after the global financial crisis was the elevation of the G20. Based on Transgovernmental network, G20 played an important role of providing the necessary political agreements to foster convergence and harmonization of rules and standards. Issues related to the CRA regulation was continuously addressed in G20 meetings and member countries revised their domestic regulations to follow the agreement. Including the US, the EU, Japan, and most of G-20 countries

focused on strengthening CRA regulation after 2008. This paper aims to discuss global changes of CRA regulations and examines how Asian countries had reacted to such changes, and analyzes what led to implantation of international standard into domestic regulation in some countries, why the EU re-organized CESR to ESMA with more centralized supervision, and why there was lack of cooperative approach in Asia concerning CRA regulation supervision.

Keywords: Asian Bond Market Development, Credit Rating Agencies (CRA) Asian Bond Market Initiative (ABMI), supervisory regulation, financial market development, G20

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1. Introduction

The Asian Financial Crisis of 1997 was a wakeup call for most of countries in Asia to realize their underdeveloped bond markets and dependence on bank finance. Once it was recognized that the underdevelopment of bond market was considered one of the factors contributing to financial crisis, alarmed Asian governments realized the necessity of building a regional bond market in Asia through number of initiatives. In order to tackle the double mismatch problem and enhance the capital market in Asia, the Asian Bond Market Initiative (ABMI) was a major step to strengthen the region's financial system by focusing on 6 different criteria assigned by each working group in 2003. Institutional improvement for regional financial integration shows steady progress after launch of ABMI. Credit Guarantee and Investment Facility (CGIF) was established to guarantee bond issues within the region and the creation of ASEAN+3 Bond Market Forum (ABMF) shows further progress to discuss approaches for harmonization and integration of regulations.

Asia's Bond market had been developed with extra-national initiatives and institutional development. The total size of bond market had been increased, but there remains more room for further development especially for corporate

bond issuance and secondary market liquidity. This paper aims to focus on the role of credit rating agency in the bond market. Credit rating agencies are closely related with development of bond market. By reducing the informative asymmetry between investors, and issuers, analyzing and evaluating the creditworthiness of corporate, CRA plays important role in the market. A need for enhancing the credit rating system in Asia by utilizing domestic credit rating agencies was proposed by the ABMI. Having a fair and a reliably CRA system is crucial to increase international investors and to further develop the region's bond market was shared by member countries. In order to develop more integrated CRA in Asia, there had been a private cooperation between Domestic Credit Rating Agencies (DCRA) called Association of credit rating agencies in Asia (ACRAA). To improve the member CRA's rating methodology and quality of analysis, ACRAA regularly hold workshops, and also to discuss the best practice in rating dialogues among representatives had been organized. Also there had been a suggestion on the need for a regional credit rating agency. Utilizing global credit rating agency (GCRA) was also suggested, but the majority of GCRA's standards are primarily designed for developed countries and do not reflect differences of the credit ratings in Asia which are highly concentrated in low credit ratings. Despite the need of having more harmonized regulation and standard for DCRA, there hadn't been much progress in

coordinated effort towards CRA regulation. However CRA regulation received large attention after the global financial crisis and G20 provided a platform to agree on strengthen regulation for CRA supervision. As a result, not only the US but also the EU, Japan and other member countries began to implement international standard as their domestic regulation.

Purpose of the research

After the establishment of ABMI and ACRAA, there had been extensive discussion on building more harmonized system or RCRA, but problems of building credibility and reputation raised back in 2000s still remain, and much cooperation on improvement has not been made by neither private or public initiative. The purpose of this thesis is to discuss the development of bond market in Asia through harmonization of regulation and supervision related to Credit Rating Agencies. This paper examines how CRA supervisory regulations in ASEAN+3 countries were revised to implement international standard. It is extremely difficult to set up a whole new RCRA based on harmonized regulation that is feasibly applicable for all Asian economies, or leave this matter only on the hands of private entities. The main goal of cooperation is to establish credibility and reputation on DCRA. Regulatory approach to set a

standard for supervision could provide effective guideline for Asian economies based on harmonized standard of supervisory regulation. By focusing on the mechanism that led to harmonization of international standard, this paper aims to analyze process and incentives of national authorities' change of regulation.

Research Question

Financial crisis often causes improvements in the regulatory structure and the Global financial crisis generated reform on CRA supervision in G20 countries. This paper aims to compare the development of a new regulatory framework in Asian economies.

The first part of the research will answer the following: what are the changes made in regulatory supervision on DCRA after the global financial crisis?

In order to preserve financial stability, national-level financial regulation is crucial. Despite the fact the EU had created advanced regional institutions and achieved certain degree of high integration and harmonization of rules and standard, significant differences in national practices remained without full

harmonization of regulations. After the global financial crisis, the EU was successful to a new organization called European System of Financial Supervisors (ESFS) which conducts micro-prudential supervision of individual financial institutions. The European Securities and Market Authority (ESMA) have been tasked with the direct supervision of credit rating agencies. Europe and Asia are defiantly different from economic development, openness and depth of financial market, and to institutional capacity. However, EU's experience reflects important lessons, which could provide a solution for appropriate regulatory cooperation in Asia.

The second part of the research will answer the following: what led to implantation of international standard into domestic regulation in some countries in Asia, why the EU re-organized CESR to ESMA with more centralized supervision, and why there was lack of cooperative approach in Asia concerning CRA regulation supervision?

Analytical Framework

This paper references Beth Simmons' framework in 'The International Politics of Harmonization: The case of Capital Market Regulation'. She argues that "dominant financial center's regulatory innovation, enhancement, or

deregulation has the potential to bring significant changes in financial market and hence it affects regulators in the rest of the world”¹ In order to explain the harmonization process, the incentives of other jurisdictions to emulate the dominant financial center’s regulatory changes, and the significant externalities caused by implementation of regulation were used as two dimensions. In her research, the US acted as a hegemonic superpower in terms of regulatory innovation and depending on other jurisdictions wiliness to emulate the US’ regulatory changes, and externalities caused to the US resulted in different ways of enforcing or ignoring regulatory changes in other countries. By using this framework, this paper sets G20 as dominant financial center and analyzes how it had influenced regulator changes in other jurisdictions. Before analyzing the regulation reform on CRA, the research will first introduce the background of bond market development in Asia. Afterwards explains Asia governments’ regulation reform on CRA after the global financial crisis, Microprudential policy in EU.

¹Simmons BA. *The International Politics of Harmonization: the Case of Capital Market Regulation*. International Organization [Internet]. 2001;55 (3) :589-620.

2. Background

2.1 Bond Market Developments in Asia

The Asian Financial Crisis of 1997 was a wakeup call for most of countries in Asia to realize their underdeveloped bond markets and dependence on bank finance. ‘Double mismatch’ problem was highlighted during the crisis. Most of Asian countries were depending on bank financing rather than national or regional capital market which made most of the firms financed in the form of short-term loans. Despite high saving rates in East Asia, these savings were invested into in the form of safe assets and long-term investment in industrialized countries.² Currency mismatch simply means the danger of exchange rate fluctuation. Most of firms’ domestic sales and investments were in local currency, but when they borrowed from foreign currency, it may weaken the balance sheet of the firm, which Eichengreen referred as ‘Original sin’.³ The underdevelopment of bond market was considered as one of the factors contributing to financial crisis, awakened governments of Asian countries to build a regional bond market in Asia through number of initiatives.

² Mun, U-sik, and Yong sup Yi. *Asian Monetary Integration: Coping with a New Monetary Order after the Global Crisis*. Cheltenham, UK: Edward Elgar, 2012. Print

³ Eichengreen, Barry, Ricardo Hausmann, and Ugo Panizza. "The Mystery of Original Sin." *Other People's Money* (n.d.): 233-65. Web.

In order to encourage the development of Asian bond market by using the international reserves of central banks, the first Asian Bond Fund (ABF) was launched in 2003. Members of 11 central banks from the southeast and pacific regions of Asia were committed to invest U.S \$1 billion in sovereign and quasi-sovereign dollar bonds. In 2004, Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) initiated the second fund of ABF2 to promote local currency denominated sovereign and quasi-sovereign bond. The launch of ABF2 was expected to play an important role of stimulate new products, strengthen market infrastructure, and improve the regulatory barriers. The framework of ABF2 announced by EMEAP in 2004 contained two units of Pan Asian Bond Index Fund (PAIF) and a Fund of Bond Funds (FoBF). The PAIF is a single bond fund investing in sovereign and quasi-sovereign domestic currency-denominated bonds issued in the eight EMEAP markets. The FoBF has a two-tier structure of parent fund investing in eight sub funds. Total amount of investment in the ABF2 by EMEAP member is around US\$2 billion.⁴

The establishment of the Asian Bond Market Initiative (ABMI) was a major step to strengthen the region's financial system by focusing on 6 different

⁴ Press Statement EMEAP Central Banks Announce the Launch of the Asian Bond Fund 2 16 December 2004 <http://www.emeap.org/wp-content/uploads/2015/04/16dec04.pdf>

criteria assigned by each working groups in 2003. Six working groups were organized by ASEAN+3 to conduct studies of market structure on voluntary basis.⁵In order to develop well functioning regional bond markets, the following issues were recognized: 1) Possibility of establishing Asian Regional Guarantee Facilities and provision of credit guarantees by utilizing existing guarantors. 2) Enhancing the rating system by strengthening the role of DCRA, and examine the possibility of creating an Asian Credit Rating Board 3) Establishment of a mechanism to provide information on issuers and CRA 4) Foreign exchange transactions and settlement issues on cross border transactions 5) Development of technical assistant program for human resource development and promotion of policy dialogue and 6) Examination of legal and institutional infrastructure.⁶In May 2006, six working groups were reorganized into the four engaged in the development of the market infrastructure and several new studies were endorsed. However there were growing concerns over the overall progress in the ABMI. More specific actions were required for the development of well functioning bond market to meet increased regional investment. A new road map was introduced in 2010. Task force (TF1) promotes issuance of local currency denominated bonds. Credit Guarantee and Investment Facility (CGIF)

⁵Regional Integration of Capital Markets in ASEAN, Jaseem AhmedV. Sundararajan, *Global Journal of Emerging Market Economies* Vol 1, Issue 1, pp. 87 - 122

⁶ "Chairman's Press Release on the Asian Bond Markets Initiative." *ASEAN | ONE VISION ONE IDENTITY ONE COMMUNITY*. N.p., 01 Feb. 2016. Web. 28 Dec. 2016.

was created in 2009. The main function of CGIF is to provide guarantee for local currency denominated bond to support ASEAN+3 companies to access the region's bond market. Because of low credit rating of the underdeveloped Asian economies, access to the bond market was limited. Hence CFIF is aiming to help companies to secure longer-term financing, reduce their short-term financing from foreign currency to solve currency and maturity mismatches. In order to facilitate the demand of local currency-denominated bonds, Task force 2 focuses on improvement of investment environments for investors and necessary information is circulated through Asian Bond Online. Task force 3's primary focus is improvement of regulatory framework. This force eventually lead to creation of the ASEAN+3 Bond Market Forum (ABMF) in 2010 as an organization to encourage the standardization of market practices and harmonization of regulations in Asia, and develop integration with rest of the world in international standard setting and rule making.⁷ Task force 4 focuses on development of related infrastructure for the bond market such as framework for securities settlement, encouraging credit culture, and improving professional services.

⁷*ASEAN 3 Bond Market Guide*. Mandaluyong City: Asian Development Bank, 2012. Print.

2.2 Current situation and Challenges

Institutional improvement for regional financial integration shows steady progress after launch of ABMI. Credit Guarantee and Investment Facility was established to guarantee bond issues within the region and the creation of ABMF. This shows further progress to discuss approaches for harmonization and integration of regulations. According to Bank of International Settlement (BIS) report, total size of markets has grown due to the strong increase in government debt securities.

Size of local-currency debt markets in EMEAP economies									
Amount of debt securities outstanding as a percentage of nominal GDP									Table 1
	2005			2010			June 2015		
	Corp	Govt	Total	Corp	Govt	Total	Corp	Govt	Total
ABF2 economies:									
China	3	36	39	10	39	50	19	34	53
Hong Kong	38	9	47	33	38	72	29	36	65
Indonesia	2	16	18	2	12	14	2	13	15
Korea	40	43	83	58	44	102	76	53	129
Malaysia	31	41	72	38	54	92	41	54	95
Philippines	1	39	39	4	31	36	6	30	36
Singapore	28	37	65	26	41	67	32	50	82
Thailand	8	35	43	12	51	63	17	55	72
Other EMEAP economies:									
Australia	52	13	65	60	26	86	60	43	103
Japan	17	147	165	19	178	197	16	205	221
New Zealand	8	20	28	20	26	47	28	26	54
Reference:									
United States	35	55	90	44	84	128	46	93	139

The ABF2 initiative was to enhance to enhance the local currency bond market focusing on government and quasi-government bonds. Report concluded “at least in the larger ASEAN countries – Indonesia, Malaysia, the Philippine, Singapore and Thailand- the government bond markets had already achieved sufficient depth and liquidity to be able to play their appropriate economic roles. These markets already allowed reasonably efficient market-based financing of government deficits and already provided benchmark yield curves. These developments, however, had not appeared to spark active secondary markets for corporate bonds.”⁹

Shimizu pointed out four market development challenges. The first is coping with differences in market scale and development stage. Because of different developmental stage in each Asian economies, government have different attitude towards regional financial cooperation.¹⁰ The second challenge is achieving further growth in corporate bond market. Compare to development of Government bond market, there is still room for further expansion in corporate bond market. Japan, Singapore, Hong Kong, and Korea

⁸ Marlene Amstad, Steven Kong, Frank Packer and Eli Remolona. *A Spare Tire for Capital Markets: Fostering Corporate Bond Markets in Asia*. Bank for International Settlement, n.d. Web. 27 Dec. 2016.

⁹ Amstad, 3.

¹⁰ Shimizu, S. 2010. “The Development of Asian Bond Markets since the Global Financial Crisis.” *Pacific Business and Industries* 10(38):2–36.

are relatively advanced and liquid while in China, India, Indonesia, and Thailand are still at early stage of development.¹¹ Majority of issuers are government-affiliated corporations especially in China and Malaysia. Especially in China, capital for infrastructure and housing investment are largely financed through local government finance vehicles (LGFV) which typically issued in the form of enterprise bonds. Also in the Philippines and Indonesia, natural resources utilities, and infrastructure firms dominate bond issuance.¹² It is important to include more private sector companies to the market.

Improving the liquidity of secondary market is considered as the third challenge. Due to increase of government bond market, liquidity was increased but there is still room for more improvement. The main reason for illiquidity of secondary market is majority of investors only being banks and other financial institutions, especially for government bonds. According to the research from Deutsche Bank, limited availability of risk management products and short trading period of corporate issues need to be improved with legal infrastructure.¹³ Also properly designed 'transparency' (amount and timeliness of the information provided to the investing public regarding prices and

¹¹Levinger. 2014, H. Levinger What's behind recent trends in Asian corporate bond markets? Deutsche Bank Research. Deutsche Bank (2014)

¹² Levinger, 8.

¹³ Levinger, 9.

quantities)¹⁴ of market will lead to increased liquidity and encourage investor participation.

The fourth challenge is raising investor confidence by enhancing market transparency through improvements in information disclosure and by harmonizing regulations. Recent growth in corporate market did not lead to crucial upgrading of supporting market structures such as standardized credit rating systems.¹⁵ Eichengreen pointed out poor regulatory quality, corruption, and not enforcing business firms to adopt international standard are additional issues to small size and fragmentation of underdevelopment of Asia's bond markets. Government needs to encourage firms to follow internationally recognized standards and further develop the regulation and enforce through combination of policies.¹⁶

¹⁴ Marlene Amstad, Steven Kong, Frank Packer and Eli Remolona. *A Spare Tire for Capital Markets: Fostering Corporate Bond Markets in Asia*. Bank for International Settlement, n.d. Web. 27 Dec. 2016. Pg 14

¹⁵ Levinger. 2014, H. Levinger What's behind recent trends in Asian corporate bond markets? Deutsche Bank Research. Deutsche Bank (2014)

¹⁶ Eichengreen, Barry, and Pipat Luengnaruemitchai. "Why Doesn't Asia Have Bigger Bond Markets?" *SSRN Electronic Journal* (n.d.): n. pag. Web.

2.3 Regulation Harmonization

After the Asian financial crisis, there had been cooperative effort to develop the bond market in Asia. For the further growth of bond market, Asia still faces various problems and one of the major tasks is considered as ‘harmonization on regulation and standard’. Dalla pointed out areas of harmonization to support the development of bond market such as having regulations related to foreign exchange and legal framework, clearing and settlement measure, and CRA requirements.¹⁷ However, harmonization on standard and regulation not only requires market participants, finance minister, but also requires national authority to carry out the measure. Although it is considered as necessary measures to harmonize regulatory framework, it is extremely difficult process and requires a greater political commitment.¹⁸ ASEAN+3 Finance Ministers and Central Bank Governors regularly meet to discuss recent global and regional economic development and policy responses. Issues were continuously reviewed through Chiang Mai Initiative Multilateralization (CMIM), ASEAN+3 Macroeconomic Research Office (AMRO), and Asian Bond Markets Initiative (ABMI). These initiatives

¹⁷ Dalla, Ismail. 2003. *Harmonization of Bond Market Rules and Regulations in Selected APEC Economies*. © Asian Development Bank. <http://hdl.handle.net/11540/259>.

¹⁸Ibid

are arrangements among countries without legal obligation, binding rules or dispute settlement mechanism. The networks formed by financial ministers and central bank governors created a platform for regional governance based on soft law approach and each working groups are focused on resolving specific issues for developing bond market. However, the core issue of taking responsibility for supervision still stays with national regulators. Previously, international cooperation on rule making achieved certain degree of harmonized standards such as Basel agreement. While issues related to accounting, securities, and capital adequacy have been discussed to set international standard, macro and microprudential supervision and systemic risk regulation were paid less attention before the global financial crisis.¹⁹ After the crisis the US, EU, and other major jurisdictions emphasized more intensive oversight of financial institutions and the reform effort proposed included. Despite the important role of supervisor for implementing and enforcing regulation based on international standard, it is difficult step to harmonize the supervision. Even within the EU's agreement financial supervision had been responsible for each member states for its implementation, but the recent crisis awakened impact of ineffective national supervisory system which could threaten stability among all member

¹⁹ Pan, Eric J. (2010) "Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks," *Chicago Journal of International Law*: Vol. 11: No. 1, Article 9.

states. The global financial crisis reminded many countries where self-enforcing regulation was not enough to prevent from financial turmoil. Although Asia was not directly involved in 2008 crisis, it is worth examine changes of regulation on supervision of CRA in member countries and promote cooperation for prevention on crisis and as well as enhancing current situation for development of DCRA and bond market in Asia.

2.4 The role of Credit Rating Agencies and regulation in Bond Market

Asia's Bond market had been developed with extra-national initiatives and institutional development. The total size of bond market had been increased, but there are more room for further development especially for corporate bond issuance and secondary market liquidity. Credit rating agencies are closely related with development of bond market and original working groups of ABMI five emphasized on local and regional credit rating agencies. By reducing the informative asymmetry between investors, and issuers, analyzing and evaluating the creditworthiness of corporate, CRA play important role in the market. Financial globalization lead expansion of CRA's role and after Basel II incorporated the CRA rating's into the rules for setting wrights for credit risk,

impact on CRA rating on market had been more increased.²⁰

Domestic Credit Rating Agencies (DCRA)

The need for enhancing the credit rating system in Asia by utilizing domestic credit rating agencies was proposed in Asian Bond Market Initiatives (ABMI). A view of having fair and reliably CRA system is crucial to increase international investors and to further develop the region's bond market was shared by member countries. Asian Banker's Association presents general findings based on series of survey and interviews conducted by 11 Asian countries with DCRA, regulators and investors. According to investors' opinion, eighty percent of all investors use their own in-house research department to conduct credit ratings assessments, and refer to DCRA rationales primarily as information sources.²¹ The major finding from many international investors was DCRA are not credible. In order to enhance credibility of DCRA following four areas need to be improved.

²⁰ Bhatia, A.V., 2002. Sovereign credit ratings methodology: An evaluation. IMF Working Paper 02/170, International Monetary Fund, Washington

²¹ *Development of Regional Standards for Asian Credit Rating Agencies: Issues, Challenges and Strategic Options*. Taipei: Asian Bankers Association, 2000. RAM Consultancy Services Sdn Bhd of Malaysia. Web.

1. Independence

- Political independence
- Independence of ownership
- Independence from the client

2. Transparency

- Rating process
- Rating methodologies
- Potential conflicts of interest

3. Accuracy of Ratings

- Skepticism about the accuracy
- Timeliness in rating action

4. Quality of Analysis

- Insufficient information is disclosure

Private sector initiatives: Association of credit rating agencies in Asia (ACRAA)

In 2001 at the Asian Development Bank Headquarters in Manila, 15 Asian CRA from 10 countries formed Association of credit rating agencies in Asia (ACRAA) which currently increased to 30 members from 14 countries. To improve the member CRA's rating methodology and quality of analysis,

ACRAA regularly hold workshops, and also to discuss the best practice in rating dialogues among representatives had been organized. In 2011, ACRAA adopted “code of conduct fundamentals for domestic credit rating agencies” and its listed norms are monitored among members. In 2004 during the 6th Tokyo Roundtable on Capital Market Reform in Asia, Mr. Kazuo Imai, Chairman of ACRAA defined harmonization as “convergence of various practices and rating principles across borders.”²² Considering different market structures and internal process of each member it is not a simple task to achieve but he emphasized that harmonization effort to understand best practices should be a continuous action.²³

For future development of regional credit rating market, alternative approaches were suggested. The first alternative is based on private initiatives utilizing DCRA with ACRAA to standardize the rating and enhance the rating capacity. Based on the private approach, market competition would be secured and most cost effective for governments, also each member state remains to have autonomy of national regulation. However, the doubt about feasibility and desirability standardization had been raised and Securities and Exchange Commission (SEC) in the U.S undertook ‘credit rating standardization study’.

²²“ACRAA and Harmonization under Asian Bond Market Initiative” By Mr. Kazuo Imai
Chairman, Association of Credit Rating Agencies in Asia On the Occasion of(n.d.): n. pag. 6th
Tokyo Roundtable on Capital Market Reform in Asia, Sept. 2004. Web. 29 Dec. 2016.

²³Ibid

The result concluded that SEC does not have the authority to pursue credit rating standardization. Also the issue of feasibility of standardization was raised because most of commenter answered that having a harmonized standard would not increase accountability, and competition in CRA industry. Rather than requiring CRA standardization increased transparency was suggested as alternatives measure.²⁴ Besides the issue of standardization, private initiatives need to deal with foreign recognition and regulatory burden, and most importantly incentive problem. Recent report by the Japan Credit Rating Agency (JCR) in 2015 mentioned although original aim of ACRAA had been standardize the rating process among DCRA back in 2000, impracticality of mapping the different rating scale remained as high hurdle.²⁵

Suggestions for establishment of Regional credit rating agencies (RCRA)

After the Asian Financial crisis, a need for local currency bond market had been grown to enhance cooperation among ASEAN+3 which resulted in different kinds of initiatives to develop the Asian Bond Market. ABF and AMBI contributed to deepening bond market, particularly sovereign bond, and

²⁴ SEC Staff, Report to Congress, Credit Rating Standardization Study (Sept. 2012), pp. 2-3, available at <http://www.sec.gov/about/offices/ocr.shtml>

²⁵ Satoshi Nakagawa. *Perspective on "Roles of Regional Credit Rating Agencies"*. Japan Credit Rating Agency. Web.

recognized importance of developing regional credit rating capacity. Launch of AMBF shows ASEAN+3 members' determination of creating a platform for harmonized regulation and standardized market practices, but no visible achievement had been made in regard to harmonization of market practices.

Majority of East Asia countries have their own domestic credit rating agencies (DCRA), which are mostly affiliated with global credit rating agencies (GCRA). DCRA mainly focuses on rating domestic bonds. In 2004 Bank of International Settlement (BIS) and Korea University held a conference of central bankers, scholars, and market participants in Seoul.²⁶ Various issues related to Asian bond market were discussed including a necessity of building a common credit rating system. Daekeun Park and Changyong Rhee emphasized on the need for a regional credit rating agency.²⁷ Even though utilizing global credit rating agency is more cost effective, GCRA's standards are primarily designed for developed countries and do not reflect differences of the credit ratings in Asia which are highly concentrated in low credit ratings. While most of sovereign credit ratings of North America, European countries and Japan have AAA or AA ratings, emerging countries received ratings from A to B for foreign currency debt by GCRA. GCRA's rating causes issue of 1) emerging

²⁶BIS Papers No 30 Asian bond markets: issues and prospects Monetary and Economic Department November 2006

²⁷ Ibid

marker's lower credit rating and 2) narrow range of credit quality. Since the corporate bonds ratings are lower than sovereign rating, most of Asian corporate bonds will be lower than BBB, and DCRA's rating usually tend to be higher than GCRA's.²⁸ Problem of concentrated distribution limits a wider range of investment choices. Standardization for introducing a regional credit rating system had been discussed to adopt a common standard through mutual cooperation among DCRA's in Asia.

The second alternative suggested to set up a Regional Credit Rating Agency (RCRA). If the establishment of RCRA is possible regional credit rating capacity would be drastically increased and bring more institutional investors in the ASEAN+ regions and as a result of cross-border bond market growth, overall Asian bond market will be more developed and integrated. Opposite view of establishing RCRA concerns with credibility and independent being a public entity, also gaining a mutual recognition from all member country and curtail private sector involvement in the CRA market. A centralized CRA to cover Asia region would require extensively high cost of building a database, local human resources all covered by government.²⁹

²⁸Ibid

²⁹이창용, 박대근, 박재하, 오규택, 2005 아시아채권시장의인프라구축: 예탁결제및신용평가기구설립방안, 한국경제의분석제 11권제1호.

3. Asia's regulation reform on CRA after the Global Financial Crisis

Despite the credit rating agency's important role in development of capital market, issues directly related to further improvement for CRA was not addressed after the establishment of AMBI. ACRAA's original plan of expanding harmonization of regulation faced structural difficulty and it was not clear how standardization would contribute to enhancement of credibility and reliability of DCRA. An alternative suggestion of establishing RCRA had been recommended by a few scholars, but the issue of independence and gaining mutual recognition from all ASEAN+3 countries remained as high hurdle. However, the biggest change of CRA regulation happened after global financial crisis. The regulatory framework for CRA had not been addressed especially related to supervision until recently. The Global Financial Crisis of 2008 had a large impact on both G20 countries and emerging economies, allowing governments to recognize the importance on CRA supervision. As a result, major developed countries initiated reform of domestic regulation. In the US, the Dodd-Frank act had profound impact on credit rating industry. The Dodd-Frank act enhanced the Securities and Exchange Commission's (SEC) enforcement mechanisms and also added number of requirements on NRSRO.

New regulation of CRAs immediately came into force.³⁰ Previously US regulation on CRA was mostly self-enforcing because of CRA's own interest to maintain a high standard and quality for good reputation. Global financial crisis addressed various problems related to CRA and the new regulation aimed to introduce a series of rules of transparency, accuracy of rating, quality of analyses, information disclosure, and conflict of interest. Followed by the US, countries in Asia also strengthened domestic regulations regarding supervision of CRA. In order to ensure independence and high quality ratings of the CRA, the Securities Commission Malaysia (SC) issued Guidelines on the Registration of Credit Rating Agencies in 2011.³¹ In Thailand, a resolution to allow amendment of regulation governing local and foreign credit rating agencies was passed in 2011 in response to the changing business environment and IOSCO standards.³² The Hong Kong Securities and Futures Commission's (SFC) conducted a public consultation in 2010 and decided that SFC will regulate and license CRA.³³ The monetary Authority of Singapore (MAS) released a consultation paper in 2011. After consultation and discussion with the industry

³⁰ Elisabeth Van Laere A new regulatory framework for credit rating agencies, Global Credit Review <http://rmi.nus.edu.sg/gcr/files/02%20GCR%20vol%201.pdf>

³¹ "SC to Enhance Oversight on Credit Rating Agencies (CRAs)." *Media Release*. SECURITIES COMMISSION MALAYSIA, Mar. 2011. Web. 29 Dec. 2016.

³² "SEC Revises CRA Oversight Rules." *SEC News Release*. The Securities and Exchange Commission, Dec. 2011. Web. 29 Dec. 2016.

³³ "SFC to Regulate Credit Rating Agencies from 1 June 2011." *All News*. Securities and Future s Commission, Apr. 2011. Web. 29 Dec. 2016.

and market participants, MAS introduced regulatory framework for CRA in 2012. Under the new framework, CRA will be regulated under the Securities and Futures Act (SFA) and all CRA need to be licensed under the Capital Markets Services licensing regime. New regulation brought changes in complying with new Code of Conduct for CRA by MAS and CRAs are required to comply with existing regulations under the SFA.³⁴As Japan, Malaysia, and Thailand are the main countries that officially amended their domestic regulations in response to the crisis, the next chapter will examine further details of change.

3.1 Japan

Japan was the first country in Asia to develop domestic CRA from 1980s and currently following CRAs are registered in Japan: Fitch Ratings Japan Limited, Japan Credit Rating Agency, Moody's Japan, Moody's SF Japan, Rating and Investment Information, Standard & Poor's Ratings Japan, Nippon Standard & Poor's. The Financial Instruments and Exchange Act (FIEA) was amended in 2009 and was put in force in April 2010. The newly amended act established a registration system for CRAs and the registered CRA are under supervision of

³⁴ Room, Reading. "MAS Introduces Regulatory Framework for CRA." Monetary Authority of Singapore, n.d. Web. 29 Dec. 2016.

the Financial Service Agency (FSA). The main purpose of regulation is to ensure independence of CRA from issuers and prevent conflicts of interest, and strengthen quality and fairness in the rating process. Japan's regulatory framework is created to achieve the objectives of the IOSCO principles. CRA are required to take necessary measures to enact policies for quality control for registration. After registered, CRA is needed to develop functions to check effectiveness of its credit rating determination policies.³⁵ Credit Rating Agencies are required to maintain fairness and integrity all times³⁶ and also required to maintain internal records which includes not only fundamental information but also names of the rating analysts and committee members. Those records are required to be kept for five years.³⁷ Sufficient personnel with the expertise and skills must be secured to conduct its credit rating business.³⁸ In order to ensure fair execution of credit rating business, CRA is required to take measures to have policies regarding compensation arrangements. Credit Rating Agencies need to publish rating policies on a timely basis which include policies and methods pertaining to the determination of credit ratings, and need to ensure those public disclosures are made without delay.³⁹

³⁵ Cabinet Office Ordinance on Financial Instruments Business, etc., Article 306(1)(vi)(d).

³⁶ Ibid Article 306(1)(i).

³⁷ Ibid 315(1).

³⁸ Ibid Article 306(1)(vi)(a).

³⁹ Ibid Article 313(1).

3.2 Malaysia

The Security Commission is a primary authority in Malaysia in charge of the regulations and activities in capital market. The SC encourages and promotes the development of securities market, and governs domestic bond market and CRAs are required to be registered with the SC. The SC recognized drastic changes in supervisory standards on CRA in other jurisdictions including the US, EU, and Japan after global financial crisis. Followed by major economies amendment on CRA supervision, the SC conducted consultation with key players in the domestic bond market to develop the guideline. In order to ensure Malaysia's CRA to follow with the international standards set out by IOSCO and other advanced countries, Guidelines on the Registration of Credit Rating Agencies was introduced in 2011. This Guideline issued under section 377 of the Capital Market and Service Act (CMSA) provides regulatory and supervisory requirements for CRAs.⁴⁰

The SC Guideline VIII deals with operation requirements which require a CRA to have adequate infrastructure and information system to provide reliable bond rating services⁴¹ and to keep proper records. Accounting records and

⁴⁰ "ASEAN+3 Bond Market Guide 2016: Malaysia." Asian Development Bank, Oct. 2016. Web. 29 Dec. 2016.

⁴¹Guidelines on the Registration of Credit Rating Agencies 2.37

other books are required to be kept not less than seven years.⁴² To ensure appropriateness of expertise and information, VII human resources and expertise requires a CRA to have qualified analysts who are competent to carry out rating assignments and subsequent monitoring of the bonds.⁴³ The SC guideline V specifically looks at ‘Independence, objectivity, and conflict of interest.’ In order to maintain its independence and professionalism, the CRA need to comply with the Malaysian Code of Corporate Governance on the structure of its Board of Directors⁴⁴ and ensure that CRA rating is not influenced from its shareholders and its Board of Directors.⁴⁵ To maintain independent and prevent financial pressures, a CRA need to maintain minimum shareholder’s fund specified by the SC⁴⁶. Shareholding structure is important to carry out independent and objective ratings. A CRA is required to disclose the shareholding structure in public, and the SC must approve major changes of shareholding. The guideline IV requires a CRA to ensure timely disclosure and adequately publish all information⁴⁷ A CRA is required to establish an effective communication channel with users, subscribers, and stakeholders to ensure

⁴²Ibid 2.39

⁴³Ibid 2.33

⁴⁴ Ibid 2.20

⁴⁵ Ibid 2.21

⁴⁶ Ibid 2.2

⁴⁷ Ibid 2.13

accountability of its rating opinions and promote investor activity.⁴⁸ A definition of ‘default’ with a historical record of default list should be disclosed in a public.⁴⁹ Historical default rates of the CRA rating and changes made in default rates of these categories also need to be published to help readers to understand historical performances.⁵⁰ The criteria and methodologies are set out in Appendix of the SC guideline and a CRA is required to consistently and systemically apply those rating criteria and methodologies.⁵¹ The Security Commission has investigative and enforcement powers which means that non-compliance of this guideline.⁵²

3.3 Thailand

The Security and Exchange Commission (SEC) of Thailand was established in 1992 as an authority with respect to the regulation and activities of the Thai bond market. In 2011, the SEC has passed a resolution to allow change of the regulation related to governing local and foreign CRA in response to change of global financial environment and to follow with the IOSCO standards. The SEC secretary general mentioned that Thailand’s CRA

⁴⁸ Ibid 2.15

⁴⁹ Ibid 2.17

⁵⁰ Ibid 2.19

⁵¹ Ibid 2.5

⁵² The notification the Securities and Exchange Commission 5.1

regulations should be updated as the global financial environments are moving forward with tightened supervisory regulation. Newly amended supervisory regulation of Thailand will help to increase credibility of CRA, enhance information disclosure, and reduces conflict of interest. This change will help investors to use CRA information and rating more efficiently and confidently.⁵³ The notification the Securities and Exchange Commission No.KorChor. 1/2555 came into force as from May 2012.

To ensure quality and integrity in the rating process, Clause14 (3) emphasizes use of reliable and referable sources of information and review the result of credit rating to prevent former analyst later works for business where he or she participated in issuing. To ensure appropriateness of expertise, a CRA is required to assign personnel with sufficient knowledge and understanding of instruments⁵⁴ and also sufficient number of personnel with work experience for undertaking CRA businesses.⁵⁵ In order to remain independence and to avoid conflicts of interests a CRA are required to have following measures. A CRA are prohibited to have business relations with a business for which CRA performs duty as advisor or giving advice related to business structure, and a

⁵³ "SEC Revises CRA Oversight Rules." *SEC News Release*. The Securities and Exchange Commission, Dec. 2011. Web. 29 Dec. 2016.

⁵⁴ The notification the Securities and Exchange Commission14-2

⁵⁵ Ibid 11-5

business which CRA is a holder of securities issued.⁵⁶ Also employees are prohibited to have following relationship with the business 1) employee is holder of securities, 2) performs duty as advisor, 3) related in the manner that maybe unable to issue credit rating independently or express impartial opinion.⁵⁷To ensure sufficient information for the public, a CRA need to disclose 1) the latest result of credit rating, 2) methodology and procedures 3) cash flow analysis 4) any error in previous evaluation, historical default rate⁵⁸

The Securities and Exchange Commission may issue a suspension or revocation order if CRA fails to comply with the requirements.

⁵⁶ Ibid 15-2,ab

⁵⁷ Ibid 15-3 abc

⁵⁸ Ibid 16-12345

4. Microprudential policy in EU: CRA regulation and ESMA

4.1 The Regulation of CRA before the global financial crisis

In Europe, the efforts to ensure market integration through supervisory model began to emerge after the financial crisis. Previously, the EU was seeking greater harmonization, and cooperation but the process of building regulation harmonization did not require member countries to give up their supervisory power to a single European financial market Agency.⁵⁹ Even in Europe where greater financial integration was achieved, supervision regulation was still on hands of national authorities. In order to enhance more harmonized implementation of standard, Lamfalussy process was proposed. The proposal by Lamfalussy is divided into four levels. First, to set out objectives that the securities legislation must achieve, Second, to set out technical requirements to achieve those objectives, third, to ensure common and uniform implementation by using common standard agreed among regulators in CESR, fourth, enforcement of the legislation. Before the global financial crisis, the regulation of CRA in Europe was based mainly on self-regulation in the form of the

⁵⁹ Pierre Schammo EU Day-to-Day Supervision or Intervention-based Supervision: Which Way Forward for the European System of Financial Supervision? *Oxford J Legal Studies* 2012 32: 771-797

IOSCO code and the Committee of European Securities Regulators (CESR) was in charge of issues related to CRA. The Committee of European Securities Regulators (CESR), Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) were established in 2001 under the terms of the European Commission. Those committees' worked as center of networks made of national authorities and various Lamfalussy process level 3 measures of guideline and recommendations were adopted.⁶⁰ The CESR had been focusing on improvement of coordination among securities regulators, and acting as an advisory group to assist the EU commission. After the Enron scandal, the European Parliament adopted a resolution on CRA in 2004, with the main concern of the quality of credit ratings provided by CRAs and calling on the commission to produce an assessment for legislative intervention. The CESR advised the EC that regulation of the credit rating is not necessary for the time being in 2005. Instead reviewing how CRAs are implementing IOSCO code of conduct was proposed. The Commission decided that no new legislative was needed since the existing securities directives cover the most of important aspects of CRA activities and CRAs are self-regulated on the basis of the IOSCO code of conduct. CESR's report in 2006 concluded that the main CRAs

⁶⁰ Schammo, 776.

generally follow the IOSCO code and CRA's activities are more transparent.⁶¹

4.2 Micro prudential policy in Europe: Establishment of ESMA

In 2007, the EC asked CESR to monitor the voluntary compliance of CRA with the IOSCO code of conduct and CESR published second paper focusing on transparency, human resources, monitor of rating performances, and the management of conflicts of interests. This report concluded that CESR will continue to encourage market driven growth. Furthermore, it was found that issues related to ratings of US subprime backed securities had no effect on regulation of CRA.⁶² CESR encouraged more participation from market players to play larger role in improvements and discipline. CESR also suggested a formation of organization to set a standard and monitor to develop compliance function in line with international standard supported by market participants. The members of the body should be decided by the international regulatory community and CRA should provide sufficient information to this body. If this is not able to achieve in short term, CESR suggested it should take

⁶¹*European Commission - Press Release - Internal Market: Commission Welcomes EU Regulators' Report on Credit Rating Agencies.* N.p., Jan. 2007. Web. 29 Dec. 2016.

⁶²*CESR's Second Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and The Role of Credit Rating Agencies in Structured Finance* (n.d.): n. pag. THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS, May 2008. Web. 29 Dec. 2016.

initiatives at EU level, and if market participants are not supportive, regulatory framework by supervisory authorities were also suggested in the report.

Later in 2008, consultation was held to discuss regulation with respect to the authorization, operation and supervision of CRA and the commission adopted proposal to regulate CRAs. The new regulation on CRA puts a common regulatory regime for the issuance of credit ratings and all CRA that operates in EU will need to apply for the registration. CESR will be in charge of applications and the college of regulators will be in supervision of CRAs. All registered CRA need to comply with rules to ensure transparent manner, avoid conflicts of interests, and develop the quality of the rating methodology and the ratings. After adopting the new regulation of 1060/2009 on CRA the commission continues to take further steps towards necessary reforms to ensure stable financial system in Europe. CESR's main function was to advise the EC and worked as center of networks made of national authorities without legally binding power. National authorities may have responded by peer pressure of loosing reputation among members if they do not follow the standard. Later, the de Larosie`re group concluded that cooperation measures of level 3 committees under Lamfalussy process hit their limits. The commission proposed more centralizes framework for supervision of CRA at EU level and under the new proposal, the European Securities and Markets Authority (ESMA) was created.

A new European System of Financial Supervisors (ESFS) was established and ESMA replaced CESR. The crisis contributed to re-organization of level 3 into European Securities and Market Authority (ESMA), European Banking Authority (EBA), and European Insurance and Occupational Pensions Authority (EIOPA). The EU members did not advocate ESA to have daily supervisory powers of individual financial institutions. The main takes will be coordinating the actions of national supervisors and work towards a “common rulebook” for all EU financial institutions. ⁶³According to the de Larosie`re group, supervision on some specific institutions such as CRA were only advocated. The ESMA’s supervision power over registered CRAs which includes the European subsidiaries of GCRA is very exceptional within ESA.⁶⁴ In order to ensure CRA’s compliance with the requirements under the regulation, ESMA performs supervisions and investigation. ESMA can request information, examines records and documentation, summon persons and conduct interviews, and inspect CRA’s business premises. If serious indication of infringements of the regulation is suspected, ESMA will appoint independent investigation officer (IIO) for further investigation. EU’s day-to-day supervision with

⁶³ Tait, Nikki. "EU Sets up Trio of Financial Watchdogs." Financial Times, 3 Dec. 2009. Web. 29 Dec. 2016.

⁶⁴*European Commission - PRESS RELEASES - Press Release - Commission Proposes Improved EU Supervision of Credit Rating Agencies and Launches Debate on Corporate Governance in Financial Institutions.* N.p., n.d. Web. 27 Dec. 2016.

centralized enforcing mechanism is exceptional arrangements. ESMA completed its first onsite inspection in 2011 focusing on the ratings of covered bonds, banks and sovereign bonds. The inspection found the Standard & Poor's, Moody's and Fitch didn't meet the standards of transparency, IT and internal controls. After the inspection those agencies were told to produce a report about risk mitigation how they will reply to ESMA's investigation result.⁶⁵ ESMA continued to investigate and ordered the big three CRAs to improve their quality, procedures, and information discourse.

⁶⁵ Masters, Brooke. "Rating Agencies Must Improve Transparency." Financial Times, 23 Mar. 2012. Web. 29 Dec. 2016.

5. Analysis of supervisory regulation reform

The regulatory framework for CRA had not been addressed especially related to supervision until recently. However, the 2008 crisis had large impact on not only developed countries but also other emerging economies to recognize importance on CRA supervision. Hence, many governments began to take actions to strengthen the regulatory framework governing CRA industries. In the US, the Dodd-Frank act had profound impact on credit rating industry. Followed by the crisis, IOSCO code of conduct was updated in 2008, and CRA task force was converted into a permanent committee and facilitates regular dialogue between securities regulators and the credit rating industry. After several consultation and based on member country's survey on whether IOSCO provision is conflicting with domestic laws and jurisdiction of member countries, a new IOSCO CRA code was adopted. While issues related to accounting, securities, and capital adequacy have been discussed to set international standard, prudential supervision of cross-border financial institutions and systemic risk regulation was paid less attention before the global financial crisis.⁶⁶ After the crisis the US, EU, and other major

⁶⁶ Pan, Eric J. (2010) "Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks," *Chicago Journal of International Law*: Vol. 11: No. 1, Article 9.

jurisdictions emphasized more intensive oversight of financial institutions and the reform effort was proposed.⁶⁷ Despite the important role of supervisor for implementing and enforcing regulation based on international standard, it was a difficult step to harmonize the supervision. Even within the EU's agreement on financial supervision had been responsible for each member states for its implementation, but the recent crisis awakened impact of ineffective national supervisory system which could threaten stability of all member states. The EU strengthened its regulatory supervision by re-organizing existing institution with more centralized approach. National authorities are still in charge of supervising individual financial institutions, the newly establish ESA with more centralized approach aims to improve the functioning of the internal market by ensuring harmonized European regulation and supervision.⁶⁸ In response to the global financial crisis, ASEAN+3 created Macroeconomic Research Office (AMRO) to monitor economic and financial risks in the region. The global financial crisis highlighted the needs of cooperation of financial sector surveillance and regulation. In regards to regulation of CRA, the EU responded by implementing CRA regulation in 2009 and later took further steps to ensure more harmonized supervision of CRA by establishing ESMA. However in Asia,

⁶⁷ *ibid*

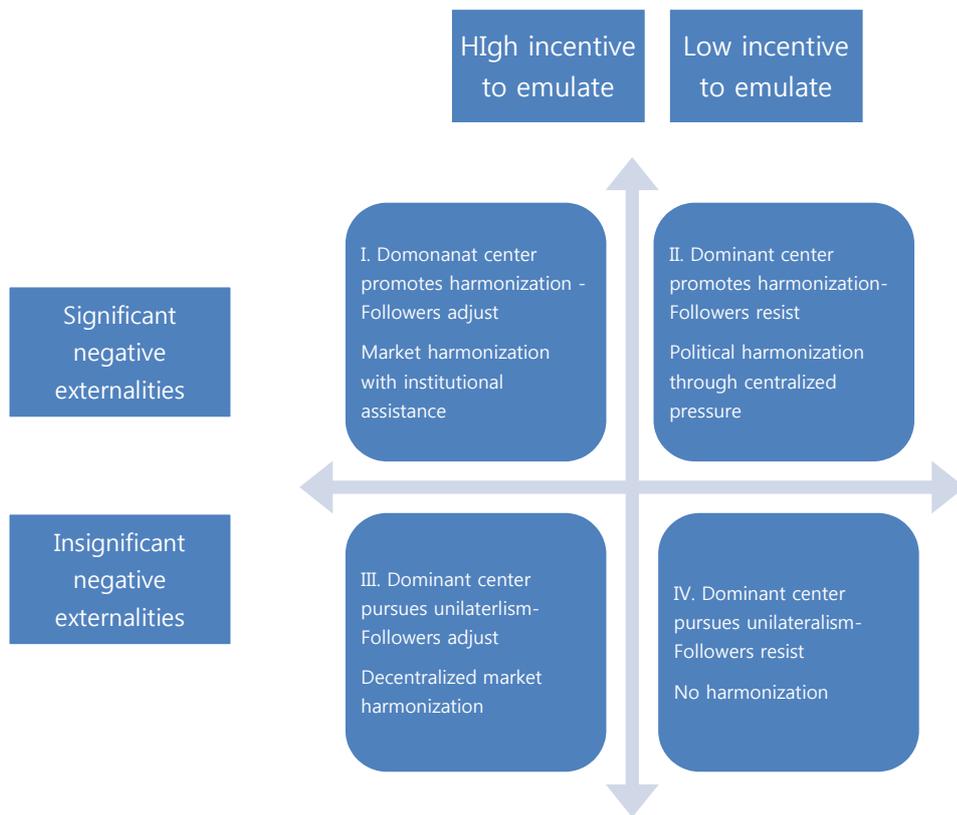
⁶⁸ESMAComms. "European Supervisory Framework." *European Supervisory Framework*. N.p., n.d. Web. 27 Dec. 2016.

issues related directly to CRA were not mentioned and countries took individual approach to regulate their domestic CRA by implementing regulation based on the IOSCO code of conduct. This paper will analyze why the EU and ASEAN+3 had taken different approach using a framework by Beth Simmons. She provided a framework to analyze the mechanisms that drives regulatory harmonization in international finance focusing on what encourages convergence.⁶⁹ Even before the global financial crisis, national authorities to properly supervisory and regulate financial market had been a huge concern. If international institutions reduce uncertainty and transaction costs, there should have been cooperative arrangements to establish market regulations. The role of market incentive and political pressure from the dominant center will be explained in the next chapter.⁷⁰

⁶⁹ Simmons BA. *The International Politics of Harmonization: the Case of Capital Market Regulation*. International Organization [Internet]. 2001;55 (3) :589-620.

⁷⁰ibid

Figure 1. Incentives for regulatory harmonization



Despite the effort to coordinate the regulation internationally, most of regulations and guidelines are based on voluntary implantation and nonbinding rules were developed by small number of national regulators or supervisors. Simmons argues *that dominant financial center's regulatory innovation, enhancement, or deregulation has the potential to bring significant changes in*

*financial market and hence it affects regulators in the rest of the world*⁷¹. When changes of regulations are made by the dominant center, the incentives other regulators emulate or diverge. The externalities produced by this reaction are important dimensions to explain whether harmonization was induced economically or politically, and what kind of role was played by international institutions in the process. The changes of regulation made by dominant financial center will bring following outcomes: it may give incentives for other regulators emulate, provide incentives for other regulators to have negative reaction or have no effects.

As seen in Figure a, in quadrant 1, regulators in other jurisdictions have a high incentive to emulate dominant center's changed regulation when potential negative externalities for the dominant center are high, and the dominant center supports these adjustments because they could face negative externalities without harmonization. The dominant center benefits from support multilateral institutional arrangement based on broad-based membership. These institutions only need to play an informational role and may provide technical assistance. In the absence of the dominant center's innovation, implementation of new standard or change of regulation may have not been preferred in other

⁷¹ibid

jurisdictions but market incentives provide other jurisdictions to adjust their own regulation. Access to the market of the dominant center pressures to have regulatory changes and encourage harmonization.

In quadrant 2 other jurisdictions resist the dominant center's regulatory changes and their reactions have a potential to create negative externalities for the dominant center. When the dominant center is already decided to implement regulatory innovation to support their own interest and negative externalities are significant, they will pressure other jurisdictions to match their financial regulations through unilateral pressure or backing multilateral institutions. If it is possible to target or divert negative externalities, making bilateral agreements or taking unilateral action are used. If negative externalities cannot be diverted at reasonable cost, the dominant financial center will press regulatory harmonization by creating multinational institutions with technical assistance as well as political pressure on noncompliant jurisdictions. "The role of multilateral institution flows from the hegemony's anticipation of externalities. These institutions can be created and used strategically by the dominant financial center to achieve its desired regulatory outcome in an economical fashion."⁷²

⁷² Simmons BA. *The International Politics of Harmonization: the Case of Capital Market Regulation*. International Organization [Internet]. 2001;55 (3) :589-620.

In quadrant 3, market incentive provides other jurisdictions to adjust their regulations and the negative externalities anticipated by the dominant center are small. Reasons to establish an international institution is minimal and harmonization is likely to happen in decentralized way. For example, accounting standards for public offering had been driven by decentralized market force, primarily the desire to enter the dominant financial center's equities markets. Simmons mentioned "Firms adjust their accounts by calculating how much they would benefit from a foreign listing. Simple market power is moving harmonization toward the dominant center's preferred accounting approach."⁷³

When other jurisdictions have no incentive to adjust their regulation and negative externalities are not significant to the dominant center, regulation harmonization is not likely to happen. Simply, other jurisdictions do not want to emulate and dominant center has no reason to create multinational institutions or give political pressure.

⁷³ibid

The G20 as a dominant financial center in the change of CRA regulation

The most significant changes of institutional arrangement change after the global financial crisis is elevation of the G20. One of the most important roles played by G20 is providing the necessary political agreements to foster convergence and harmonization of rules and standards.⁷⁴ Recent crisis showed a more need for coherent supervision based on shared interest and common value. After the crisis, lack of representatives by emerging countries in G7 meetings were raised and for broader representation in policy discussion. The elevation of G7 to G20 including “BRICs” shows acknowledgement of middle powers and recognition that the solutions for global financial crisis requires more participants from rising economies. The EU itself and major developed countries are already included as a member G20 which makes little different from Simmons framework because she used the US as only dominant center. Financial regulation and rule making had been based on Transgovernmental network. Slaughter argues it is new types of structured cooperation in response to the practical necessities of international economic and political

⁷⁴ Pan, Eric J. (2010) "Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks," *Chicago Journal of International Law*: Vol. 11: No. 1, Article 9.

interdependence.⁷⁵ Transgovernmental network is driven by government officials in one country interacting with their counterparts on other country which makes cooperative relations more horizontal and informal.⁷⁶ Transgovernmental network had been increasing especially related to environmental and financial regulations. This network does not directly involve governmental action based on 'hard law' rather main actors are informal institutions across national boundaries engaging in cooperative action to carry out various regulations. This approach is developed by frequent meetings between participants rather than formal negotiation.⁷⁷ It is clear that soft law based regulation created by transgovernmental networks does not have legally binding power, but the existence of a network strengthens incentives for jurisdictions to seek convergence.⁷⁸ The majority of transgovernmental regulation is based on issues that are already regulated in each nation but regulated in different ways. Coordination of regulation could benefit all participant member countries by ensuring other nations adopt similar approaches. Informal networks by bureaucrats to prevent future international crisis expanded its regulatory frameworks to all participation countries which is

⁷⁵ Anne-Marie Slaughter and David Zaring, *Networking Goes International: An Update*, 2 *Ann Rev of L and Soc Sci* 211 (2006).

⁷⁶ *ibid*

⁷⁷ Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 *Va J Intl L* 1 (2002)

⁷⁸ *ibid*

more flexible than international institutions. In order to effectively regulate and manage specific issues domestic actors and regulators began to interact with their foreign counterparts and developed a network where they share information, create standards, and agree on core values. G20 represent strong policy network. They played important role in the governance of international finance by providing internationally agreed standard. During the global financial crisis, the role of G20 received greater emphasis as ongoing issues of supervision policy couldn't be solved without cooperation of all member countries. G20 focused on re regulatory reform and enhancing cooperation of supervision.⁷⁹ Issues related to regulation on CRA were discussed in G20 meetings. In 2008, participants agreed that strong oversight over CRA is necessary based on international standard.⁸⁰ Prevention of conflicts of interest was considered as main parts to improve at London in 2009. Countries agreed to establish more binding regulation and set a deadline for implementation. Systemic cooperation and enhancement of existing standard was emphasized, and countries agreed on registration and supervision system for CRA.⁸¹ Also G20 called national authorities to implement FSB principles in accordance with

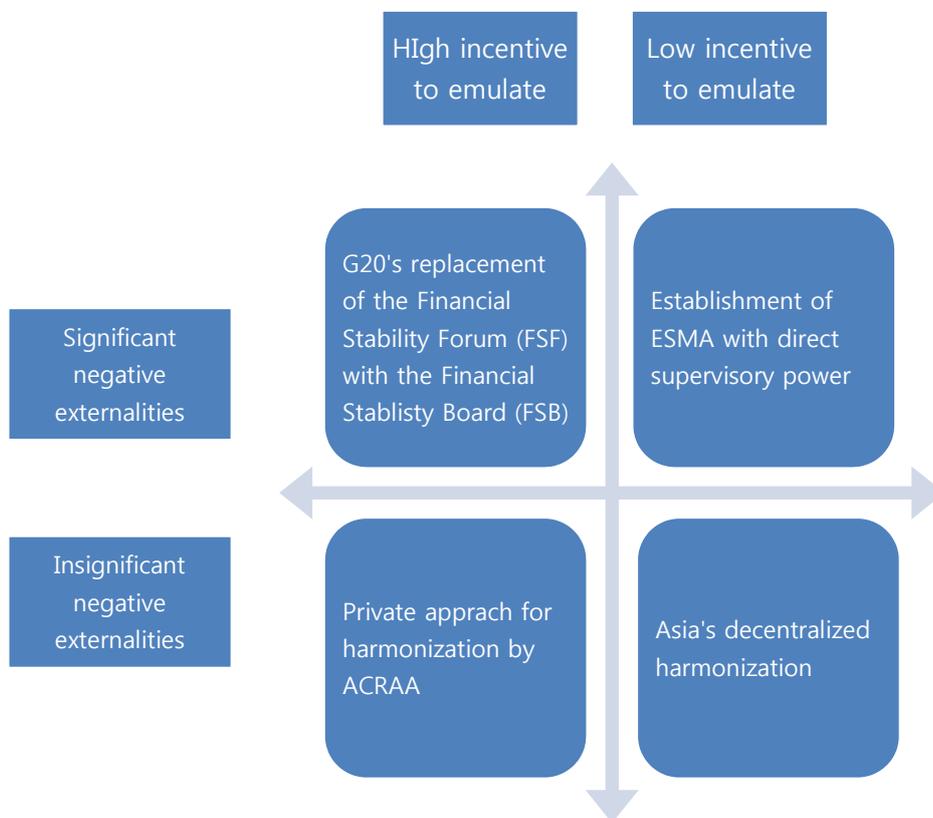
⁷⁹ Dervis, Kemal, Masahiro Kawai, and Domenico Lombardi. *Asia and Policymaking for the Global Economy*. Tokyo: Asian Development Bank Institute, 2011. Print.

⁸⁰ Utzig, S. 2010. The Financial Crisis and the Regulation of Credit Rating Agencies: A European Banking Perspective. ADBI Working Paper 188. Tokyo: Asian Development Bank

⁸¹ *ibid*

the FSB roadmap. The next chapter will examine how G20 had been pursuing regulation harmonization and how the EU and Asian countries responded to this approach.

Figure 2. Harmonization processes



5.1 The case of FSB: High negative externalities and high incentive to emulate

After G20 leaders agreed on strong oversight over CRA based on international code of conduct, other jurisdictions began to implement IOSCO code of conduct into their own domestic regulation. G20 leaders agreed to enhance oversight of CRA by establishing registration system and it is consistent with the IOSCO code. National authorities' responsibility to enforce compliance was also recognized. They agreed that CRA should distinguish ratings for structured products, and enhance information disclosure.⁸²At the Washington summit, members targeted that they should regulate institution, products and market at international level. The EU's regulation on CRA came in force from December 2010 which was a result of the EU's commitment to the G20 summit's agreement.⁸³ Japan's amendment of Financial Instruments and Exchange Act (FIEA) followed by the G20 mandate came into force in 2010.⁸⁴ Newly amended act established a registration system for CRAs and the registered CRA are under supervision of the Financial Service Agency (FSA).

⁸² Katz, Jonathan G. and Munoz, Emanuel Salinas and Stephanou, Constantinos, *Credit Rating Agencies: No Easy Regulatory Solutions* (October 6, 2009). The World Bank Group, Financial and Private Sector Development Vice Presidency, Crisis Response Policy Brief 8

⁸³ "European Commission - \ - Press Release - New Rules on Credit Rating Agencies (CRAs) – Frequently Asked Questions." \. N.p., Jan. 2013. Web. 29 Dec. 2016.

⁸⁴ Alcubilla, Raquel Garcilá, and Javier Ruiz Del Pozo. *Credit Rating Agencies on the Watch List: Analysis of European Regulation*. Oxford: Oxford UP, 2012. Print.

Japan's regulatory framework is designed to promote the objectives of the IOSCO principles. In Malaysia, the SC recognized drastic changes in supervisory standards on CRA in other jurisdictions. Followed by major economies amendment on CRA supervision, the SC conducted consultation with key players in the domestic bond market to develop the guideline. In order to ensure Malaysia's CRA to follow the international standards set out by IOSCO and other advanced countries, Guidelines on the Registration of Credit Rating Agencies was introduced in 2011.⁸⁵ In 2011, in order to remain Singapore as an attractive location for CRAs to operative, the Monetary Authority of Singapore (MAS) released a consultation paper on the proposed regulation of CRA.⁸⁶ The Hong Kong Securities and Futures Commission's (SFC) conducted a public consultation in 2010 and decided that SFC will regulate and license CRA.⁸⁷ In response to the financial crisis, G20's effort to strengthen regulatory framework influenced other jurisdictions to implement international standard as their national regulations. Besides the G20's cooperative action to supervise CRA regulation, regulators in other jurisdictions had a market incentive to emulate dominant center's changed regulation. FSA

⁸⁵ "SC to Enhance Oversight on Credit Rating Agencies (CRAs)." *Media Release*. SECURITIES COMMISSION MALAYSIA, Mar. 2011. Web. 29 Dec. 2016.

⁸⁶ Room, Reading. "MAS Introduces Regulatory Framework for CRA." Monetary Authority of Singapore, n.d. Web. 29 Dec. 2016.

⁸⁷ "SFC to Regulate Credit Rating Agencies from 1 June 2011." *All News*. Securities and Futures Commission, Apr. 2011. Web. 29 Dec. 2016.

of Japan and ESMA exchanged information regarding supervision over CRA to establish a mechanism for cross border cooperation on CRA. This Exchange of Letters (EOL) is a cooperation agreement signed between Europe and supervisory authority from other country to ensure effective supervision of CRA at an international level.⁸⁸ In 2012, the EC recognized US, Canada, and Australia's legal and supervisory framework is equivalent to the requirements of regulation in Europe. Currently, the EC recognizes Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore, and US as the third country which their regime is equivalent to the EU regulation. Access to the market of the dominant center was one of the driving factors to have regulatory changes and encourage harmonization.

Also, the dominant center supported multilateral institutional arrangement based on broad-based membership. After the Asian Financial Crisis in 1999, G7 finance ministers and central bank governors created the Financial Stability Forum (FSF) to strengthen the international financial system and promote the cooperation between national and international supervisory institutions. In response to the financial crisis, the leaders of G20 decided to expand the membership of FSF to strengthen networks between national

⁸⁸ Elisabeth Van Laere A new regulatory framework for credit rating agencies, Global Credit Review <http://rmi.nus.edu.sg/gcr/files/02%20GCR%20vol%201.pdf>

authorities and to enhance cooperation on supervision and surveillance.⁸⁹Hence in 2009 FSF was re-established as the financial stability board (FSB) with a new mandate with fifty two national regulatory agencies from twenty four countries. Primary role of FSB is not to replace existing national regulation or to create legally binding agreement. Instead, FSB focus on coordination of development of policy agenda to provide minimum standard that member country could implement to their domestic regulation. To follow up the G20's agreement to implement FSB principles, the FSB conducted peer review of national authorities. The review showed laws and regulation are uneven across jurisdictions and financial sectors, and FSB suggested that national authorities need to focus on establishing stronger internal credit risk assessment practices after the first review.

Regulation on CRA had been addressed as major reform after the global financial crisis and G20 agreed to have strong oversight over CRA based on international code of conduct.G20 agreed to replace FSF with FSB to enhance cooperation among the various national and international supervisory bodies and international financial institutions. G20 as a dominant center, it had strong incentive to have more harmonized regulation in other jurisdictions to

⁸⁹ Arner, Douglas W., and Michael William Taylor. "The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?" *UNSW Law Journal* 32.2 (2009): 488-513. Web. 30 Dec. 2016.

promote stability in the international financial system. By creating FSB, more effective implementation of strong regulatory, supervisory and other policies in the interest of financial stability were carried out. Other jurisdictions also had market incentive to match with most of countries amended regulation. As a result, regulation harmonization based on international standard was achieved with multilateral international assistant.

5.2 The case of ESMA: High negative externalities and low incentive to emulate

The EU's establishment of ESMA does not exactly fit to the quadrant 2 because as a result of G20's agreement, EU Regulation on Credit Rating Agencies came in force since December 2010. However, even after the implementation of regulation the EU continues to amend its regulation and the EC adopted a proposal to establish ESMA. The establishment of ESMA fits more appropriately between quadrant 1 and 2 because EU had high incentive to follow G20's agreement on CRA regulation but small market incentives and high negative externalities called for a creation of multinational institutions with technical assistance as well as political pressure on noncompliant jurisdictions.

This case, the EU acted as main dominant financial center in Europe to exert its centralized political pressure to member countries because externalities caused by non-regulated CRA would be severe if there is no institution to manage. When CESR suggested a formation of an international standard setting and monitoring body to develop compliance function in line with international standard, it was mentioned that if market participants are not supportive, regulatory framework by supervisory authorities were also suggested in the report. Internal Market Commissioner Michel Barnier highlighted direct market influence of credit ratings and increase of volatility in market due to over reliance of CRA. He mentioned that CRA need to improve the quality of rating process, adopt more transparent rating, and to follow stricter regulations.⁹⁰

Formation of ESMA as centralized body with investigation function of CRA was a result of political pressure rather than from market incentives. Major economies in EU, who are also part of G20 criticized CRA's influence over market and showed concern over negative externalities if CRAs were not properly regulated. German chancellor Angela Merkel and French president Sarkozy demanded a review of how the CRAs evaluate government debt and publicize their decisions.⁹¹ Especially during the Eurozone crisis, global CRA's

⁹⁰ "European Commission - - Press Release - Commission Wants Better Quality Credit Ratings." N.p., n.d. Web. 30 Dec. 2016.

⁹¹ Barber, Tony. "European Leaders Hit at Rating Agencies." *Subscribe to Read*. Financial

downgrade of government bond had serious impact on adding to their borrowing cost. Merkel and Sarkozy called for a more critical review of using CRA in European regulations.⁹² The EU's new CRA regulation focuses on registration, conduct of business and supervision. The ESMA has exclusive supervision powers over registered CRAs which includes the European subsidiaries of Fitch, Moody's and S&P. In order to ensure CRA's compliance with the requirements under the regulation, ESMA performs supervisions and investigation. ESMA can request information, examines records and documentation, summon persons and conduct interviews, and inspect CRA's business premises. If serious indication of infringements of the regulation is suspected, ESMA will appoint independent investigation officer (IIO) for further investigation.⁹³ ESMA completed its first onsite inspection in 2011 focusing on the ratings of covered bonds, banks and sovereign bonds. The inspection found the Standard & Poor's, Moody's and Fitch didn't meet the standards of transparency, IT and internal controls. After the inspection those agencies were told to produce a report about risk mitigation how they will reply

times, 7 May 2010. Web. 30 Dec. 2016. <<https://www.ft.com/content/a47745ec-5959-11df-99ba-00144feab49a>>

⁹² Ibid

⁹³ Alcubilla, Raquel Garcil`a, and Javier Ruiz Del Pozo. *Credit Rating Agencies on the Watch List: Analysis of European Regulation*. Oxford: Oxford UP, 2012. Print.

to ESMA's investigation result.⁹⁴

The EC addressed that centralized supervision system is more efficient for CRA to register and process of supervision will be more consistent.⁹⁵ The EC's effort to strengthen its supervision over CRA was gradually developed after the global financial crisis. Previously in EU, CRAs voluntary implementation of IOSCO code of conduct was considered as enough measure and when CESR published a paper focusing on transparency, human resources, monitor of rating performances, and the management of conflicts of interests, the report concluded that CESR will continue to support market driven enhancement.⁹⁶ However, as global financial crisis continues and after the Eurozone faces sovereign debt crisis, regulation supervision over CRA was emphasized and even after establishing EU regulation on CRA. The EC took a further step to establish ESMA to ensure centralized supervision. Apart from G20's agreement related to CRA, the EU acted as main dominant financial center in Europe to exert its centralized political pressure to member countries because previous approach of self-enforcement of international code of conduct

⁹⁴ Masters, Brooke. "Rating Agencies Must Improve Transparency." *Financial Times*, 23 Mar. 2012. Web. 29 Dec. 2016.

⁹⁵ "European Commission - - Press Release - Commission Wants Better Quality Credit Ratings." N.p., n.d. Web. 30 Dec. 2016.

⁹⁶ *CESR's Second Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and The Role of Credit Rating Agencies in Structured Finance* (n.d.): n. pag. THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS, May 2008. Web. 29 Dec. 2016.

proved to be ineffective. Also, there was a lack of market incentives for all member countries to strongly enforce all CRAs to be properly regulated, and negative externalities would have been caused larger consequences. Hence, the EC pressed regulatory harmonization by creating multinational institutions with technical assistance as well as investigation pressure on noncompliant CRA

5.3 The case of ACRAA: low negative externalities and high incentive to emulate

After the global financial crisis most of jurisdictions were able to reform their domestic regulation to adopt international standard. However, there had been attempts to establish harmonized standard in Asia before the crisis by private initiatives. Quadrant 3 of figure 2 answers the question why private approach of harmonization wasn't able to achieve tangible result after establishment of ACRAA. In quadrant 3, market incentive provides other jurisdictions to adjust their regulations and the negative externalities anticipated by the dominant center are small. Reasons to establish an international institution is minimal and harmonization is likely to happen in decentralized way.

In Europe before the crisis, externalities caused by under regulated CRA were not acknowledged and even though there was certain international

standard set by IOSCO code of conduct it was taken as voluntary implantation. In Asia, there had been market initiative towards more harmonized standard and suggestions for regional accreditation standard, but without further incentives of entering into dominant financial center's market DCRA faced limitation of reforming their regulations in line with international standards. Establishment of a regional accreditation standard similar to the Nationally Recognized Statistical Rating Organization (NRSRO) in the U.S was considered as one of the options to enhance rating standard. The study proposed that "For Asia, criteria would best be established by regulators or an inter-government consultative task force. The same body of regulators or task force would need to audit DCRA for award and compliance to the Asian-NRSRO. Once gained, a DCRA with an Asian-NRSRO status can attain regional recognition as an issuer of credible and reliable ratings in the Asian region. This recognition can be very valuable to the rating agencies if it is tied to capital market regulations."⁹⁷ Unfortunately, no cooperative action was taken to establish such organizations and also surveys indicated that only 27% of DRCA support the idea of regional accreditation standards. The majority of DCRA responded that regulators should only play an advisory role or even no role at all with respect to

⁹⁷*Development of Regional Standards for Asian Credit Rating Agencies: Issues, Challenges and Strategic Options*. Taipei: Asian Bankers Association, 2000. RAM Consultancy Services Sdn Bhd of Malaysia. Web.

harmonization and credit ratings should be market or investor driven⁹⁸ Although market participants attempted to harmonize the standard for better quality of rating and credibility,⁹⁹ they were lacking incentive to have harmonization toward the dominant center's preferred approach because most of CRAs in Asia were only working inside domestic regions.

There had been harmonization effort by private CRAs but more than 10 years of its establishment, there hasn't been concrete process of harmonization. In 2001 at the Asian Development Bank Headquarters in Manila, 15 Asian CRA from 10 countries formed Association of credit rating agencies in Asia (ACRAA) which currently increased to 30 members from 14 countries. To improve the member CRA's rating methodology and quality of analysis, ACRAA regularly hold workshops, and also to discuss the best practice in rating dialogues among representatives had been organized. In 2011, ACRAA adopted code of conduct fundamentals for domestic credit rating agencies and its listed norms are monitored among members. ACRAA had been working together for harmonization but the result shows that it is a difficult process to achieve. Besides the issue of standardization, private initiatives need to deal with foreign recognition and regulatory burden, and most importantly incentive

⁹⁸ Suresh Menon, "Development of Regional Standards for Asian Credit Rating Agencies - *Progress & Changes*" Asian Development Bank, May 2004

⁹⁹ Ibid

problem. Recent report by the Japan Credit Rating Agency (JCR) in 2015 mentioned although original aim of ACRAA had been standardize the rating process among DCRA back in 2000, impracticality of mapping the different rating scale remained as high hurdle.¹⁰⁰ Hence, despite the private approach of establishing ACRAA for standardization, without stronger market incentives to entering into dominant financial center's market, jurisdictions didn't have enough motivations to adjust their regulations based on dominant center or international standard.

5.4 The case of no harmonization: low negative externalities and low incentive to emulate

Even after the G20's agreement on CRA supervision, Asian economies took less harmonized approach to adopt international standard by amending their domestic regulation or released a consultation paper. All of their effort was aiming at the same direction of ensuring credibility of CRAs by focusing on supervisory regulation. Asia's less harmonized approach for CRA regulation fits into quadrant 4 where other jurisdictions have no incentive to adjust their regulation and negative externalities are not significant to the dominant center.

¹⁰⁰ Satoshi Nakagawa. *Perspective on "Roles of Regional Credit Rating Agencies"*. Japan Credit Rating Agency. Web.

Countries like Japan, Malaysia, Hong Kong, and Singapore implemented international standard as their domestic regulation mainly drove by market incentives. But other jurisdiction had less intention to emulate the dominant center's regulatory changes. Also the G20 had no motivation to create multinational institutions or give political pressure because negative externalities were relatively small. Based on transgovernmental network, G20 gained its legitimacy to provide other jurisdictions to seek convergence on regulation.¹⁰¹ It is clear that after the global financial crisis, G20 had been a central network group to provide the necessary political agreements to foster convergence and harmonization of rules and standards. However, this paper argues that despite the inclusion of Asian economies into G20, their interests were not reflected and most of policy agreements were mainly towards interests of original member of G7 countries. As a result, Asian economies were reluctant to emulate to the dominant center's regulation and G20 had less incentives to exert political power over other jurisdictions. Broader inclusion of Asian countries gave opportunities to speak out regional interest at global forum.¹⁰² However, Asian countries did not raise their voice in global

¹⁰¹ Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 *Va J Intl L* 1 (2002)

¹⁰² Drysdale P, Young S (2010) "Opportunity for Asia and the G20" East Asia Forum 17 October 2010 <http://www.easiaforum.org/2010/10/17/opportunity-for-asia-and-the-g20/>. Consulted 11 November 2011

governance, rather the result shows that they were not well represented and had conflicting interests with other Asian economies. Sohn argues that focus of G20 had been reform of domestic regulation in developing countries rather than international aspect.¹⁰³ FSF which is a former organization of FSB were heavily represented by G7 countries and excluded key emerging countries. Including emerging economies into G20 was to enhance the legitimacy of the G7's dominant decision making, and even after the inclusion political influence of non-G7 economies were limited.¹⁰⁴ Kawai also argues that although G20 promoted strengthened global financial regulation, most of agenda were much carried out by developed countries. This kind of 'one size fits all' approach driven by major economies may not be suitable for Asian countries. He highlighted that Asian economies should increase their voice in global forums like the FSB and the G20.¹⁰⁵ Besides the issue of Asian economies representativeness in G20, conflicting interests of Asian countries hindered regional cooperation. Lai and Ravenhill pointed out responses from Asian participants in G20. First, they argue that Japan had been least the least enthusiastic because Japan wanted to remain as only Asian country in G7

¹⁰³Sohn I (2005) Asian financial cooperation: the problem of legitimacy in global financial governance. *Glob Gov* 11:487–504

¹⁰⁴ibid

¹⁰⁵ Kawai, Masahiro, and Peter Morgan. "Regional Financial Regulation in Asia." *SSRN ElectronicJournal* (n.d.): n. pag. Web

framework focusing more on their own domestic issues such as drive down the value of yen. Second, China was in defensive position in G20 meetings facing harsh criticism by other countries regarding China's exchange rate policies. Korea was in more enthusiastic position in attempt to play larger role between Japan and China, and Indonesia had been invisible in G20 meetings.¹⁰⁶As a result of selective representation of Asian economies in G20, most of agendas were carried by issues in developed economies.

¹⁰⁶Lai J, Ravenhill J (2012) Asia's multi-level response to the global financial crisis. *Asia Eur J* 9(2):141–157

6. Conclusion

Financial crisis often causes improvements in the regulatory structure and the Global financial crisis generated reform on CRA supervision regulation. Recent revision on domestic regulation of the Europe and Asia took different approaches. While the EU was able to achieve centralized supervision by establishing the ESMA, Asian countries had taken individual approach based on international standard without cooperative effort. This paper analyzed mechanism based on Simmons' framework to figure out what led to implantation of international standard into domestic regulation in some countries in Asia, why the EU re-organized CESR to ESMA with more centralized supervision, and why there was lack of cooperative approach in Asia concerning CRA regulation supervision.

Regulation on CRA had been addressed as major reform after the global financial crisis and G20 agreed to have strong oversight over CRA. G20 as a dominant center, they had strong incentive to have more harmonized regulation in other jurisdictions to promote stability in the international financial system, and FSB made more effective implementation strong regulatory, supervisory and other policies in the interest of financial stability. Other jurisdictions also had market incentive to match with most of countries amended regulation. As a result, regulation harmonization based on

international standard was achieved with multilateral international assistance.

The EU acted as main dominant financial center in Europe to exert its centralized political pressure to member countries because externalities caused by non-regulated CRA would be severe if there is no institution to manage and enforce. Formation of ESMA as centralized body with supervisory mechanism of CRA was a result of political pressure rather than from market incentives. Major economies in EU, who are also part of G20 criticized CRA's influence over market and showed concern over negative externalities if CRAs were not properly regulated. After the Eurozone faced sovereign debt crisis, regulation supervision over CRA was emphasized and even after establishing EU regulation on CRA, the EC took a further step to establish ESMA to ensure centralized supervision. Apart from G20's agreement related to CRA, the EU acted as main dominant financial center in Europe to exert its centralized political pressure to member countries because previous approach of self-enforcement of international code of conduct proved to be ineffective. Hence, the EC pressed regulatory harmonization by creating multinational institutions with technical assistance as well as investigation pressure on noncompliant CRA

Before the global financial crisis, despite the private approach of establishing ACRAA for standardization, without stronger market incentives to

entering into dominant financial center's market, jurisdictions didn't have enough motivations to adjust their regulations based on dominant center's regulation or international standard.

While Japan, Malaysia, Hong Kong, and Singapore implemented international standard as domestic regulation mainly drove by market incentives but other jurisdiction had less intention to emulate to dominant center's regulatory changes. Also the G20 had no motivation to create multinational institutions or give political pressure because negative externalities were relatively small. It is clear that after the global financial crisis, G20 had been a central network group to provide the necessary political agreements to foster convergence and harmonization of rules and standards. However, despite the inclusion of Asian economies into G20, their interests were not reflected and most of policies agreements were mainly towards interests of original member of G7 countries. As a result of selective representation of Asian economies in G20, Asian economies were reluctant to emulate to the dominant center's regulation and G20 had less incentives to exert political power over other jurisdictions.

Policy Suggestion

Based on the result of an analysis, harmonization on regulation requires strong market incentives, dominant financial center's political pressure, or both. Key question is how can Asian countries achieve harmonization on supervision regulation on CRA when there is less of market incentives and political pressure?

The first suggestion is a creation of an organization similar to ESMA in Asia. According to Kawai, regional regulatory architecture can contribute to fill the gap between national and global regulation which centers on G20. He suggested a creation of an Asian Financial Stability Dialogue (AFSD) which could be a ground to discuss improvement of supervision between national authorities and work as Asia's FSB.¹⁰⁷ Also ABMF focuses on creating a platform for harmonized regulation and standardized market practices. However, even when the EU had achieved greater financial integration, supervisory regulation had remained to national authorities and it was very recent development to establish the centralized organization to focus on CRA regulation with supervisory mechanism. It is possible to develop regional standard and it will contribute to increased harmonization, but the previous progress had proven slow and effectiveness is uncertain without legally binding power.

¹⁰⁷ Kawai, Masahiro, and Peter Morgan. "Regional Financial Regulation in Asia." *SSRN Electronic Journal* (n.d.): n. pag. Web

The second suggestion proposes an increase of Asia's greater participation in G20. As many scholars pointed out, Asian countries' interest were not well represented in G20 or FSB. Asian countries can take more cooperative approaches in global financial standard setting bodies to address issues are more relevant to Asian region's interest.

The third suggestion is establishment of mutual recognition system of other jurisdiction's supervision. Bilateral or multilateral acknowledgment of other jurisdiction's supervision regulation can be helpful for developing regional standard since many Asian economies already adopted international standard as their domestic regulations. ESMA's equivalence, certification, and endorsement system recognizes non-EU CRA to be used for regulatory purpose in the EU. Asian countries can adopt similar approach based on cooperation agreement to recognize other countries regulations and this can lead to have harmonized regulation for regional supervision standard.

7. Appendix. List of Abbreviations

Asian Bond Market Initiatives (ABMI)

ASEAN+3 Bond Market Forum (ABMF)

Asian Bond Fund (ABF)

Association of credit rating agencies in Asia (ACRAA)

ASEAN+3 Macroeconomic Research Office (AMRO)

Bank of International Settlement (BIS)

Credit Guarantee and Investment Facility (CGIF)

Chiang Mai Initiative Multilateralization (CMIM)

Capital Market and Service Act (CMSA)

Credit Rating Agencies (CRA)

Committee of European Banking Supervisors (CEBS)

Committee of European Securities Regulators (CESR)

Domestic Credit Rating Agencies (DCRA)

European Banking Authority (EBA)

European Insurance and Occupational Pensions Authority (EIOPA)

Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

European Supervisory Authorities (ESA)

European System of Financial Supervisors (ESFS)

European Securities and Market Authority (ESMA)

Financial Instruments and Exchange Act (FIEA)

Financial Service Agency (FSA)

Global Credit Rating Agencies (GCRA)

International Organization of Securities Commissions (IOSCO)

Local government finance vehicles (LGFV)

Monetary Authority of Singapore (MAS)

Nationally Recognized Statistical Rating Organization (NRSRO)

Regional Credit Rating Agencies (RCRA)

Securities and Exchange Commission's (SEC)

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국문 초록

아시아 채권시장 발전

: 아시아와 유럽의 신용평가기구 규제감독 변화비교

아시아 금융위기 이후 아세안+3 회원 국가들은 역내 채권 시장 발전을 위한 협력 방안을 모색해 왔다. 아시아 채권시장 이니셔티브 (ABMI)를 중심으로 구체적 실행을 위해 2003년 6개의 실무 작업반이 구성 되었다. 이후 보다 효과적인 발전을 위해 2010년 실무 작업반은 4개의 그룹으로 개편 되었고 아세안+3 채권시장 포럼 (ABMF)가 설립되었다. 아세안+3 채권시장 포럼은 역내 회원국 간 채권 발행 및 투자 촉진을 위한 채권 표준화를 논의하고 있다. 이전에도 채권 시장 발전을 위해 표준화의 중요성은 인지되어 왔으나 공통 기준을 설정을 통한 표준화를 달성하는 데에는 실질적으로 많은 진전이 이루어 지지 않았고 많은 현실적 어려움이 있다고 지적되어 왔다. 신용평가기구의 표준화를 위해서 아시아 민간 신용평가기구들이 아시아 신용평가 기관 협의체 (ACRAA)를 조성해 협력을 추진해 왔으나 신용평가 기구의 문제점으로 지적 받아왔던 투명성, 독립성, 이해상충 등에 대한 주요 문제들은 진전을 보이지 않았다. 민간 신용평가기구와 아시아에서 글로벌신용평가기구의 제한적인 역할로 인해 지역신용평가기구 (RCRA)에 대한 제안도 있었으나 논의에 그치고 있다.

2008 금융위기 이후 신용평가기구는 미국과 유럽에서 다시 주목을 받게 되었고 신용평가의 감독과 규제에 대한 문제들이 제기되었다. 이전에는 국제 기준에 따른 자발적인 규제만으로도 충분하다고 여겨져 왔으나 금융위기 이후 보다 포괄적이 규제를 위해 각국은 새로운 규제를 도입하였다. 미국은 도드-프랑크 법을 제정 하였고 유럽에서는 유럽증권시장감독청(ESMA)를 설립해 통합적인 신용평가기구에 대한 규제감독을 강화하였다. EU는 공통체적인 규제가 필요하다고 판단하여 EU내에서 활동중인 모든 신용평가기구에 대한 통합 등록 절차를 운영할 것을 규정 하였으며 ESMA는 신용평가기관에 대한 직접적인 통합 감독권을 가지게 되었다.

채권 시장의 통합적 발전을 위해 표준화를 위한 협력이 계속해서 제기 되었음에도 불구하고 아시아에서 공동체적 규제를 위한 시도는 나타나지 않았다. 아시아에서는 일본, 말레이시아, 태국, 홍콩, 싱가포르가 금융위기 이후 국제증권관리위원회기구(IOSCO)의 국제 기준에 맞춰 국내 신용평가기구에 대한 규제를 강화하였다. 본 논문은 금융위기 이후 변화한 신용평가기구 규제감독을 비교 하고 G20가 중심이 되어 어떻게 유럽과 아시아의 규제감독에 영향을 미쳤는지를 분석하였다.

키워드: 아시아 채권 시장, 신용평가기구, 금융규제감독, 아시아 채권 시장 이니셔티브

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