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Call to regulate rating agencies warrants study

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SINCE the onset of the financial crisis in Asia, there have been calls for the regulation of currency trading, which has been blamed for the depreciation of many of the Asian currencies and the turmoil in their economies.

While in the beginning of the crisis these calls came from the lone voice of Prime Minister Datuk Seri Dr Mahathir Mohamad, many in the world community are echoing this call now.

Most recently, Dr Mahathir has again called for the regulation of international rating agencies.

At the close of an international conference on the Asian financial crisis held in Kuala Lumpur earlier this week, he said the downgrading of Malaysia's credit rating by these agencies had made it difficult for Malaysia to raise foreign funds to finance the operations of both Pengurusan Danaharta Nasional Bhd and Danamodal Nasional Bhd.

He questioned the agenda of these rating agencies and the transparency of their operations and suggested that there may be a collusion among certain parties out to prevent the Government's economic recovery efforts.

Regulation, the Prime Minister said, was necessary as these agencies had taken upon themselves to rate countries without a request to do so, a departure from their original mode of operation when ratings were carried out either on the request of prospective buyers to rate a target company, or by banks to rate countries or companies seeking loans.

It is not the first time Dr Mahathir has called for the regulation of rating agencies and he has not been alone in this call.

In April, a major Japanese financial house which was frustrated by the damage caused by the ratings it received from rating agencies, suggested that these agencies be rated themselves.

In his maiden address to the annual meeting of the International Monetary Fund (IMF) and World Bank, Second Finance Minister Datuk Mustapa Mohamed had called for the creation of a mechanism that will make rating agencies accountable for their actions.

These arguments cannot be dismissed altogether since rating agencies have been known to make mistakes in their analysis in the past.

Rating agencies, on the other hand, have argued in their defence that there is no driving factor behind their ratings and their duties are to form an analysis on whether a risk of default is to be reduced or increased.

Standing by their ratings, these agencies said the assesment should not be made to please any market participant, borrower, investor or intermediary.

While both the Prime Minister and the rating agencies have compelling arguments, perhaps it is worthwhile to look at the subject of regulation and consider some issues that surround it.

One of the issues, and perhaps the most crucial, is who should be the regulators. If international rating agencies are to be regulated, then there should an authority or a commission set up specifically to regulate these agencies, which could include the International Monetary Fund or the World Bank.

In short, rating agencies must answer to an authority. For example, public listed companies in Malaysia are subject to scrutiny by the Kuala Lumpur Stock Exchange and the Securities Commission.

However, in the case of international rating agencies, they may be based in London but if requested by their client to rate a country or company in say South-East Asia, there is nothing that prevents them from doing so. Indeed, they have become part and parcel of the international economy itself.

Like currency traders, they transcend geographical barriers. Thus, any regulatory body would have to take into account this cross-boundary nature of international rating agencies.

The question of the legal standing of rating agencies needs to be looked into as well. Due to the large implications their ratings could have on others, rating agencies cannot simply rest on claims that their business is based on independence from any party.

If they profess to be experts in their field of operations, then they should be made liable for professional negligence in courts of law should they make mistakes.

Only then would rating agencies be expected to exercise fairness to parties rated and those using their services, which in the long-term would also work to the advantage of the agencies' own credibility.

Therefore while the proponents of a regulatory body or watchdog for international rating agencies have valid arguments and the international rating agencies have theirs, these issues look set to be addressed sooner or later.

While some may scoff at Malaysia's proposal to regulate the agencies, there is nothing to show at present, other than the agencies' mere assertion that they are independent.

This would appear to be rather dangerous given the considerable influence their ratings can wield.

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