

1133 RECOGNITION AND DERECOGNITION OF MICROFINANCE INSTITUTION RATING AGENCIES

The following regulations shall govern the recognition and derecognition of Microfinance Institution Rating Agencies (MIRA) that provide ratings for banks with microfinance operation.

Statement of policy. Third-party ratings of FIs provide an independent assessment which will ultimately benefit stakeholders, including the management of the covered FI. For microfinance institutions, the enhanced transparency and independent assessment can materially improve access to capital of qualified institutions and generate a useful benchmark vis-à-vis other microfinance institutions. As a matter of policy, the Bangko Sentral supports an enabling environment for the appropriate use of objective, credible and competent third-party ratings of microfinance institutions.

Pre-qualification requirements. The application of a MIRA for Bangko Sentral recognition shall be submitted to the appropriate department of the appropriate supervising department of the Bangko Sentral together with the following information/documents:

a. An undertaking that:

- (1) the MIRA shall comply with regulations, directives and instructions which the Bangko Sentral may issue from time to time; and
- (2) the MIRA shall notify the Bangko Sentral in writing of any material changes within the organization (such as but not limited to changes in management or organizational structure, rating personnel, modifications of its rating practices and financial deterioration) that may affect its ability to provide reliable and credible ratings

b. Other documents/information:

- (1) Brief history of the MIRA, major rating activities handled including information on the name of the client, type of instruments rated, size and year of issue;
- (2) Audited financial statements for the past three (3) years and such other information that may be considered relevant for selection purposes;
- (3) List of major stockholders/partners (owning at least ten percent (10%) of the voting stocks of the MIRA directly or together with relatives within the 1st degree of consanguinity or affinity);
- (4) List of directors, officers, members of the rating committee and professional analytical staff of

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the MIRA; including their qualifications, experience related to rating activities, directorship and shareholdings in the MIRA and in other companies, if any;

- (5) List of subsidiaries and affiliates including their line of business and the nature of interest of the MIRA in these companies;
- (6) Details of the denial of a previous request for recognition, if any (such as application data, date of denial, reason for denial, etc.); and
- (7) Details of all previous and pending litigations connected with the securities market against the MIRA, its directors, officers, stockholders, members of the rating committee and professional analytical staff, if any.

Minimum eligibility criteria. The Bangko Sentral will review the application based on the following basic principles:

- a. The proposed rating framework that will be used by the applicant-MIRA reflects all the material facets of microfinance operations, its attendant risks and operational challenges; and
- b. The applicant-MIRA demonstrates the technical capability, experience and organization to provide microfinance ratings that are objective, credible and transparent.

Based on the above principles, the Bangko Sentral, through the Monetary Board, may officially recognize a MIRA upon satisfaction of the following requirements. The official recognition shall be valid for a period of three (3) years and may be renewed upon assessment that the following requirements are satisfied.

c. Organizational structure

- (1) A MIRA must be duly registered with the SEC and have the necessary permits to operate;
- (2) A MIRA must have at least five (5) years track record in the issuance of reliable and credible ratings with particular experience in microfinance; and
- (3) An international MIRA that will undertake local ratings shall have a representative office in the Philippines.

d. Resources

- (1) Human resources

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- (a) A MIRA must be staffed by full-time analysts who have the demonstrated capability to competently assess the credit-worthiness of a microfinance institution (MFI). The analysts referred herein preclude support staff engaged in other functions such as, but not limited to, marketing and administration;
- (b) A MIRA must have a sufficient number of analyst so as to allow substantive interaction with the senior management and operating units of the assessed/rated entities as a routine component of the surveillance process;
- (c) The MIRA shall establish a Rating Committee, independent of its analysts, whose members have unquestionable expertise in the rating business, majority of whom must have at least five (5) years direct professional experience in rating institutions;
- (d) The directors of the MIRA must possess a high degree of competency equipped with the appropriate education and relevant experience in the rating business;
- (e) The directors, officers, members of the Rating Committee and professional analytical staff of the MIRA have not at any time been convicted of any offense involving moral turpitude or violation of the Securities Regulation Code; and
- (f) The directors, officers, members of the Rating Committee and professional analytical staff of the MIRA are not currently involved as a defendant in any litigation connected with violations of the Securities Regulation Code nor included in the Bangko Sentral watchlist.

(2) Financial resources

- (a) The MIRA must have financial capability to support viable operations such as, but not limited to, the necessary technology and infrastructure to ensure the effective processing of data/information and the timely release of reliable and credible ratings; and
- (b) The MIRA must have financial independence that will allow it to operate free from economic and political pressures.

e. Objectivity

- (1) The MIRA must employ an assessment methodology which is accepted as a global standard. Where the MIRA uses its own proprietary framework, said methodology must have been in market use for at least three (3) years with demonstrable credibility;

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- (2) The assessment methodology used by the MIRA must be based both on qualitative and quantitative approaches; and
- (3) Said assessment methodology must be subjected to periodic review to ensure that it is responsive to changes in the operations of assessed/rated entities.

f. Independence

- (1) The MIRA must be free from control of and undue influence by the entities it assesses/rates;
- (2) The assessment process must be free from ownership pressures to allow the management of the MIRA to exercise independent professional judgment;
- (3) Persons directly involved in the assessment process of the MIRA are free from conflicts of interest with assessed/rated entities; and
- (4) The MIRA cannot assess/rate its affiliate or subsidiary or any other entity in which the MIRA has control.

For purposes of this section, a *subsidiary* refers to a corporation, more than fifty percent (50%) of the voting stock of which is owned or controlled directly or indirectly by the MIRA, while an *affiliate* refers to a corporation, not more than fifty percent (50%) but not less than ten percent (10%) of the voting stock of which is owned or controlled directly or indirectly by the MIRA. "Control" exists when the parent owns directly or indirectly through subsidiaries more than one half (1/2) of the voting power of an enterprise unless, in exceptional circumstance, it can be clearly demonstrated that such ownership does not constitute control. Control may also exist even when ownership is one half (1/2) or less of the voting power of an enterprise when there is:

- (a) power over more than one half (1/2) of the voting rights by virtue of an agreement with other stockholders;
- (b) power to govern the financial and operating policies of the enterprise under a statute or an agreement;
- (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body;
- (d) power to cast the majority votes at meeting of the board of directors or equivalent governing body; or
- (e) any other arrangement similar to any of the above.

e. Transparency

- (1) A general statement of the assessment methodology used by the MIRA should be publicly

available;

- (2) The rationale of ratings issued and risk factors considered in the assessment should be made available to the public; and
- (3) The ratings issued by the MIRA should be available both to domestic and foreign institutions with legitimate interest.

f. Disclosure Requirements

(1) Qualitative Disclosures

(a) Definition of ratings along with corresponding symbols; and

(b) Material changes within the MIRA (such as but not limited to changes in management or organizational structure, rating personnel, modification of rating practices, financial deterioration) that may affect its ability to provide reliable and credible ratings.

g. Quantitative Disclosures. Rating transitions of assessed/rated entities over time, i.e., the likelihood that the current rating of an entity will change to another rating (either higher or lower) over time.

h. Credibility

- (1) The MIRA must have a general reputation of high standards of integrity and fairness in dealing with its clients and conducts its business in ethical manner;
- (2) The MIRA is generally accepted by predominant users in the market (i.e., issuers, investors, bankers, FIs, securities traders); and
- (3) The MIRA must carry out its rating activities with due diligence to ensure ratings are fair and appropriate.

i. Internal compliance procedures

- (1) The MIRA must have the necessary internal procedures to prevent misuse or unauthorized disclosure of confidential/non- public information; and
- (2) The MIRA must have rules and regulations that prevent insider trading and other conflict of interest situations.

Derecognition of MIRA.

a. Grounds for derecognition. MIRAs may be derecognized, upon evaluation of the appropriate

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supervising department of the Bangko Sentral, under the following circumstances:

- (1) Any willful misrepresentation and/ or falsification of information/documents required under this Section.
 - (2) Failure to maintain compliance with the requirements under this Section.
 - (3) Involvement in illegal activities such as ratings blackmail; creation of a false market or insider trading; divulging any confidential information about a client without prior consent to a third party without legitimate interest; indulging in unfair competition (such as luring clients of another rating agency by assuring higher ratings, etc.)
 - (4) Failure to deliver credible, objective and transparent ratings as prescribed in this Section; and
 - (5) Any violation of applicable laws, rules and regulations.
- b. Procedure for derecognition. A MIRA shall only be derecognized upon prior notice and after being given the opportunity to defend itself.