



الوكالة الإسلامية الدولية للتصنيف  
Islamic International Rating Agency

**October 2008**



# Common Objectives of Regulators

- Containment of risks
- Sufficiency of disclosure
- Protection of less sophisticated investors
- Prevention of possibility of fraud



# Role of Rating Agencies

- Reduce asymmetry in information
- Give independent and unbiased opinion in simple code
- Maintain high standards of professionalism to earn confidence among investors



# A Brief History of Ratings

- Moody's Investors Service, a publisher established in 1900, stole the idea for ratings from Dun & Bradstreet in 1909 to enhance the value to investors of his statistical manuals
- Fitch Investors Service established 1913; ratings from 1924
- Standard Statistical and Poor's Corp merged in 1923
- Rating agencies' strength is derived from the creditability and reliability of their opinions and research
- Since 1985, entrepreneurs, IFC and governments have sponsored the formation of about sixty agencies



# Stage of Development of Islamic Capital Markets

- Important players are GCC countries, Malaysia, Indonesia, Turkey & Pakistan
- Equities market developed to a respectable size
- Debt market relatively new and developing
- Sukukmarket showing rapid growth
- IFSB, AAOIFI, IIRA contributing to development of capital markets



# Efficient Capital Market

- provides disintermediation
- reduces reliance on banking sector for funding needs
- reduces costs of funds
- aligns funding cost to risk profile of borrower
- provides diverse avenues for liquidity management

Credit Ratings accelerate development of capital market



# Some Regulatory Requirements in South & South East Asian Countries

- Compulsory rating of banks
- Compulsory rating of Sukuk and certain other debt instruments
- Minimum rating benchmarks for companies issuing certificates of deposits and certificates of Mudharabas



# The Need for developing a Rating Agency in this Region?

*“Development of credit rating agencies..... is a key institutional reform to help develop corporate and sub-sovereign bond markets, as well as asset-backed securities markets...”*

**- Observations by International Monetary Fund (IMF) in Financial Sector Assessment: A Handbook**

**In the Constituent General Assembly of IIRA, His Excellency, Dr. Ahmed Mohamed Ali, President of IDB stated:**

*“The establishment of IIRA is a cornerstone of the Islamic banking industry...The first aim to be achieved in relation to IIRA is to receive recognition of it from bodies and institutions concerned with control and management of money markets throughout the world and in particular central banks...”*



# Shari'a Compliance

- Central pillar of Islamic financial institutions
- Is a continuous process
- Requires independent monitoring



# Islamic International Rating Agency

- The “Ten-Year Framework and Strategies” for Islamic Financial Services Industry Development includes establishment of a Rating Agency. In line with this strategy, Islamic Development Bank (IDB) took steps to establish IIRA in 2002
- Other participants included well-known banks from different countries and two rating agencies
- IIRA has many Sponsors ensuring IIRA’s independence and avoiding dominance
- IIRA started its operations in late 2005, and is now recognized by Central Bank of Bahrain as an ECAI
- IIRA is generating awareness of ratings in the region
- Volume of inquiries is growing
- IIRA has been voted the Best Islamic Rating Agency in 2006 according to a poll conducted by Islamic Finance News



# Principal Benefits of Rating - Issuers

- Places the name on the “credit map” (globally-understood symbols)
- Exposes an issuer’s management to best practice
- Assists with diversification of investor base
- Means of communicating creditworthiness to key counterparties
- Internal management tool to assist financial and strategic planning
- Enhances the transparency of financial market players
- Ratings are usually necessary to access financial markets
- Facilitates secondary market liquidity
- Assists in bringing efficiency and stability in the financial system
- Ratings can bring clarity to a bank’s status as a counterparty



# Principal Benefits of Rating-Investors

- A primary tool to use in investment decisions
- Expert analysis can provide useful insights
- Research reports reflect independent opinions
- Over time, investors and Investment Account Holders will come to rely on ratings
- Reduce information asymmetry by providing an independent opinion on an issuer's risk profile
- Provide a qualitative and quantitative analysis forecasting future net free cash flow and relative payment capacity
- Provides an appropriate pricing framework for the market



# What is an IIRA Rating?

An independent, objective opinion regarding the relative capacity to meet financial obligations, including Islamic returns



# **IIRA's Ratings are NOT:**

- Recommendations to buy, sell or hold
- A guarantee against loss
- An Audit

## **IIRA's Definition of Default**

- An issuer's failure to meet its obligations on time



# IIRA's Competitive Advantages

- The management of IIRA consists of top class professionals, from different countries, with an in-depth knowledge and experience
- IIRA's target regions include: GCC countries, Other Islamic countries in Middle East and North Africa, South Asia, and Far East
- IIRA employs international best practice
- IIRA is the only agency based in the region
- IIRA has superior regional knowledge that results in superior conclusions
- IIRA is the only agency that offers Shari'a Quality Rating (SQR)
- The value model for IIRA rests on the role of ratings in efficient pricing, and the quality of supporting research



# IIRA's Competitive Advantages - *Cont'd...*

- IIRA is completely independent and transparent, follows a consistent methodical and rigorous analytical process and subscribes to a code of conduct/ethics which is consistent with the IOSCO code of conduct for rating agencies as well as Basel II
- Rating Committee: IIRA's Rating Committee consists of core members plus occasional experts. All Rating Committee members are completely independent and have no conflict of interest with the entity or instrument to be rated
- IIRA's website [www.iirating.com](http://www.iirating.com) makes full disclosure regarding its ownership, management, rating methodology for all its services and rating scales and definitions



# IIRA and Basel-II ECAI Requirements

1. Objectivity – IIRA has rigorous and systematic methodologies; Assessments are subjected to ongoing review; IIRA maintains records for Backtesting, its ratings and transactions
2. Independence – IIRA is fully independent and not subject to political or economic pressures; Assessment process is free from any conflicts of interest emanating from BoD or shareholders
3. International access/Transparency – The assessments are available to both domestic and foreign institutions



# IIRA and Basel-II ECAI Requirements

4. Disclosure – IIRA’s assessment methodologies including the definition of default, the time horizon and the meaning of each rating are publicly available; Actual default rates experienced in each assessment categories and the transition of assessments are being maintained
5. Resources – Sufficient resources to carryout high quality credit assessments are available; Ongoing contacts with senior and operational level within the entities assessed are maintained
6. Credibility – is being gradually built up derived from above criteria; and supported by existence of internal procedures & standards



# IIRA's Recognition as ECAI by CBB

المدير التنفيذي للرقابة المصرفية

Executive Director - Banking Supervision



مصرف البحرين المركزي

Central Bank of Bahrain

You letter of 12<sup>th</sup> February covers the six eligibility criteria and your reasons for why you believe that IIRA satisfies these criteria. I confirm that IIRA is recognised by the Central Bank as an External Credit Assessment Institution (“ECAI”). There are some points in relation to the above criteria where I would appreciate your comments going forward and which we may wish to discuss with you when we make our next periodic reassessment of ECAIs.

## A. Objectivity

The methodologies outlined by you appear to be rigorous and systematic, however your website shows no methodology (as yet) for commercial entities. Will you be releasing such a document soon, and would you please forward a copy for our reference? Second, would you please outline how you will be back-testing your ratings as time progresses.



# Committee of European Banking Supervisors (CEBS) Guidelines on the Recognition of ECAI

Two modes of supervisory recognition are set out in the Capital Requirements Directive (CRD) of CEBS:

- Direct Recognition: supervisors make their own evaluation of an ECAI's compliance with the recognition criteria
- Indirect Recognition: supervisors recognize an ECAI based on recognition in another Member State, without carrying out their own evaluation process. This can be a valuable instrument for enhancing efficiency and reducing administrative burdens
- Following the above indirect approach adopted by CEBS, a GCC country should recognize a rating agency as ECAI based on a recognition by another GCC country



# IIRA's Mission and Services - I

The mission of IIRA is to foster development of the financial markets in which it operates through provision of:

- Ratings for Sovereigns
- Traditional bond/Sukuk Ratings and Rating framework to permit rational pricing
- Insurer Financial Strength Ratings
- Shari'a Quality Ratings to reflect institutional compliance
- Issuer Ratings
- Specialist, focused Corporate Governance Ratings
- Real Estate Project Ratings
- IIRA provides ratings for all types of issuers and issues



# IIRA's Mission and Services - II

- A periodic summary bulletin of market activity and ratings
- Economic commentary from a credit and investment quality perspective
- Detailed rating reports to enhance the investment decision process
- Sector reports clarifying company status within industry groupings
- A record of actual and prospective money and capital market activity
- Analysis of financial institution counterparty risk for treasurers
- Seminars on the analytical principles employed by rating agencies



# IIRA's Shareholders

IIRA has in its shareholding group:

## **A. Multilateral Finance Institutions**

1. Islamic Development Bank (56 members, Headquarters Saudi Arabia)
2. Islamic Corporation for the Development of the Private Sector, Saudi Arabia

## **B. Rating Agencies**

1. Capital Intelligence Ltd., Cyprus
2. JCR-VIS Credit Rating Co. Ltd., Pakistan
3. Malaysian Rating Corporation Berhad, Malaysia

## **C. Banks and Insurance Companies**

1. Kuwait Turkish Participation Bank Inc., Turkey
2. Bahrain Islamic Bank B.S.C., Bahrain
3. Arcapita Bank B.S.C., Bahrain
4. Abu Dhabi Islamic Bank, United Arab Emirates
5. Takaful Malaysia, Berhad, Malaysia



## **IIRA's Shareholders - *Cont'd...***

6. First Investment Company K.S.C., Kuwait
7. Pakistan Kuwait Investment Company (Pvt.) Ltd., Pakistan
8. Arab Islamic Bank, Palestine
9. Dubai Islamic Bank, United Arab Emirates
10. Bosna Bank International, Bosnia
11. Al-Baraka Banking Group, Bahrain
12. Jordan Islamic Bank, Jordan
13. Bank Islam Malaysia Berhad, Malaysia
14. Dubai Bank, United Arab Emirates
15. International Leasing & Investment Company, Kuwait
16. A.K. Bakri & Sons (Bermuda) Ltd.



# List of Assignments

1. Kuwait Turkish Participation Bank, Turkey
2. Republic of Turkey
3. Syarikat Takaful Malaysia Berhad, Malaysia
4. Bank Muamalat Indonesia (BMI), Indonesia
5. Albaraka Banking Group, Bahrain
6. Kingdom of Bahrain
7. Rasameel, Kuwait
8. Injazat Capital, Dubai
9. Arab Islamic Bank, Palestine
10. Kuwait Turkish Evkaf Finance House, Turkey
11. Bahrain Islamic Bank, Bahrain
12. Other (confidentiality)

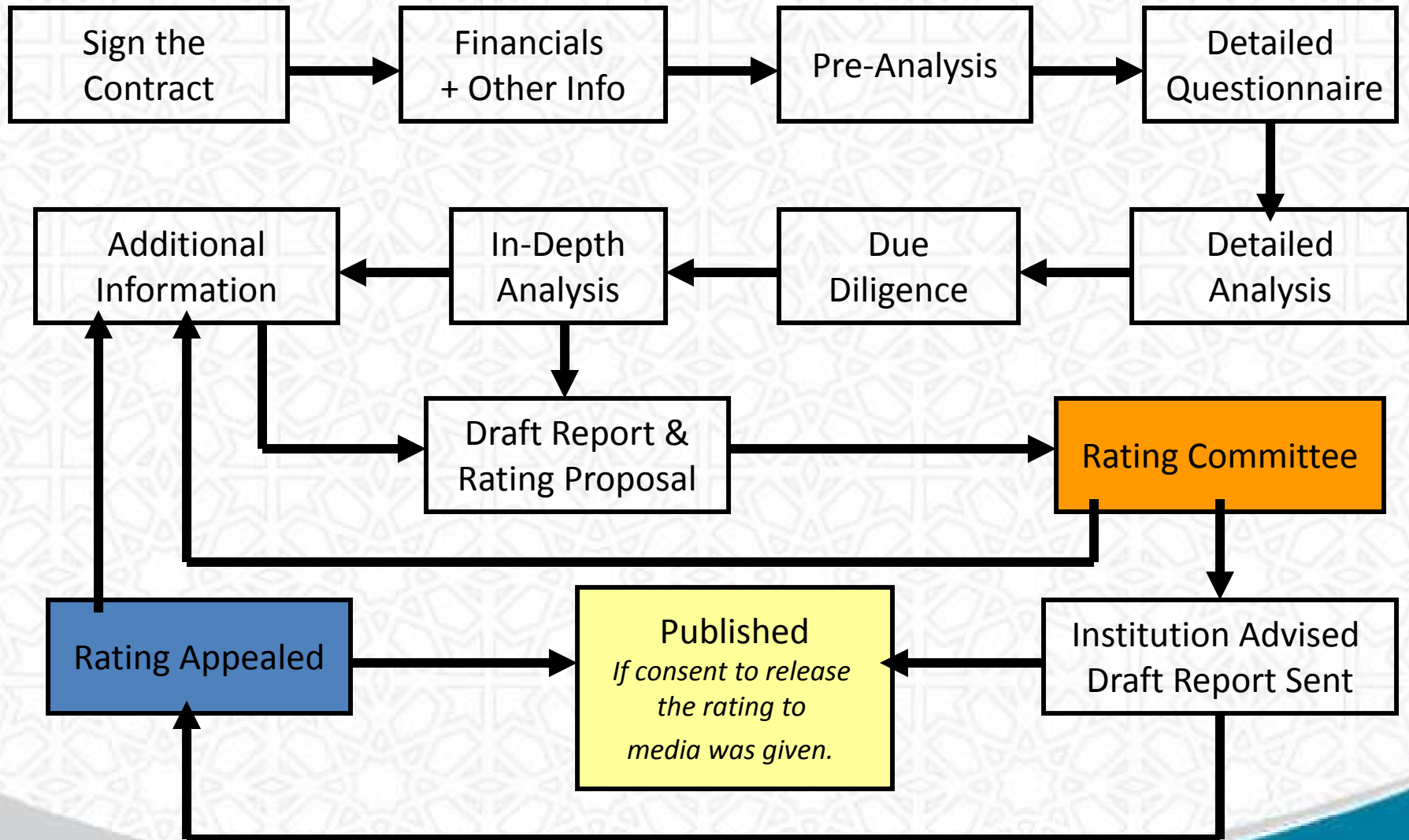


# IIRA's Rating Process

IIRA Rating Process	
<b>Issuer/Client</b>	1. Signs agreement for an initial rating
	2. Submits preliminary information materials
<b>IIRA</b>	3. Conducts a preliminary study
	4. Submits a detailed questionnaire to the issuer/client
<b>Issuer/Client</b>	5. Provides detailed information in response to detailed questionnaire
<b>IIRA</b>	6. Conducts pre due diligence meeting analysis
	7. Conducts due diligence meetings
	8. Conducts post due diligence analysis
	9. Brief for internal rating committee meetings is prepared
<b>Rating Committee</b>	10. Decides the preliminary/initial rating
<b>IIRA</b>	11. Notifies issuer of the preliminary/initial rating
<b>Rating Committee</b>	12. Deliberates on appeals by issuer/client and gives decision
<b>IIRA</b>	13. Notifies the decision of the Rating Committee to the issuer/client
<b>Issuer/Client</b>	14. Consents to release of the rating to the public
<b>IIRA</b>	15. Releases the rating to media



# IIRA's Rating Process



# Issuers' Rights & Obligations

## Rights:

- Confidentiality
- Right of non publication
- Right to appeal

## Obligations:

- Full and complete information
- Full cooperation with IIRA's team
- Inform IIRA about any significant event that have an impact on issuer's performance



# Post Assignment Monitoring of Outstanding Ratings

- Continuous Information Gathering
- Regular Contact with Issuers
- Rating Reviews
- Rating Changes
- Default and Transition Studies



# Information Requirements for Rating Applicants

- Information needed often goes beyond the published information
- IIRA does not insist on specific format in which information is to be provided
- Any format in which the institution MIS generates information is acceptable though illustrative data entry exhibits are provided to help client understand the information needs
- Strict confidentiality is maintained through out the rating process. The non public client data obtained at any stage of the rating exercise is subject to strict confidentiality



# Samples of information required

1. Annual Reports, preferably for the last five years
2. Interim reports for the last two years
3. A summary of current period performance as reflected in management reports.
4. Examples of recent market research employed in the planning process.
5. Individual financial statements for principal subsidiaries (balance sheet, income statements and cash flow statements) for the last two years.
6. Strategic Plans over the planning horizon, capital and operating budgets for the next two years
7. Ownership details, guarantees, lending or borrowing relationships



# *Thank You*

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