

Corporate Governance

Perhaps one of the areas that was found really wanting was the way the organizations were being managed. While a lot of work has been done in the area of corporate governance, the recent crisis also demonstrated that the organizations have shown very limited willingness to implement the corporate governance principles in letter and spirit. During the last two to three years, further new initiatives have been taken at the market and regulatory levels. However, there needs to be an independent, unbiased and knowledgeable body that can have a detailed examination of the institutions and provide their opinion about the application of the corporate governance principles. Rating agencies, in their nature qualify to be independent, unbiased and knowledgeable and therefore can fill this gap. We would argue that the regulators may even think to introduce these ratings as mandatory for the first few years until it becomes a market norm.

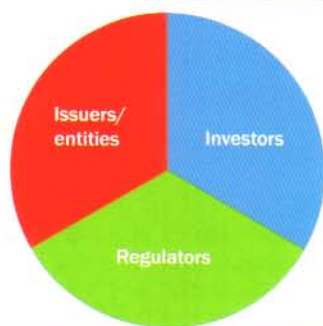
Shariah Quality

Equally important to corporate governance and perhaps more important is for Islamic financial institutions to demonstrate to their stakeholders that they have implemented enough controls to ensure that all of their operations are in full compliance with Shariah. Most retail customers and a large number of wholesale customers interact with Shariah compliant institutions, because of faith related matters and therefore trust these institutions that whatever is being said is actually implemented as well. The stakeholders must realize that this trust should be maintained and it would be reassuring to all the stakeholders if an outside body knowledgeable in this area examines the working of the organization and gives opinion on their Shariah aspects. Rating agencies would be best to do this job.

WHAT NEEDS TO BE DONE BY THE STAKEHOLDERS

The value chain of the market revolves around three main sets of players; issuers / entities, investors, and regulators. Each one has to play its role to ensure that rating agencies continue to enjoy the confidence of the market and in turn create suitable internal mechanisms to reduce the probability of the events that happened in 2007-2008.

Market value chain



The entities / issuers especially in the emerging markets need to realize that the more they become transparent, the more they will enjoy the confidence of the investors / depositors which in turn will open the venues of funding for them. A large number of big and small entities in the emerging market are still unrated and so is the Sukuk market where there are a significant number of unrated issues. The issuers need to realize that if they go through the rating route, it would bring them a wider range of investors than the traditional ones that they are currently focusing on. The entities / issuers also need to get more transparent through rating of their corporate governance and Shariah mechanisms.



Regulators have to increase the supervision and monitoring of the rating agencies by having a periodic look at their methodologies and ensure that those methodologies are implemented in letter and spirit in a consistent manner. Regulators also have a great role to play in promoting competition between the rating agencies. This can be achieved by recognition to the relatively new local or regional rating agencies.

While no one argues that such recognition should be given after a very thorough review of the management and procedures of the new rating agencies, nevertheless they should be given an opportunity to present their case. This will help to not only increase transparency and disclosure but also to provide regulators and investors a chance to judge the quality of work and the rating basis of each of the competing organizations. In order to develop a rating culture, the regulators may also need to explore whether mandatory ratings are necessary in their jurisdictions. The mechanism of mandatory ratings has been found to be very effective in a number of countries including Malaysia, Pakistan, India and Sri Lanka.

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Perhaps the most important player in this value chain is the investor community as they are the ultimate beneficiary and victim of the actions of other regulators. They need to understand whether this oligopolistic nature of the rating industry is to their benefit or not. The way to encourage competition is to allow the relatively newer / smaller players to rate their entities / issues. If they continue to have the same herd mentality and do not participate in breaking down the oligopolistic nature of the rating industry, then maybe the future may have a similar nature of events waiting.

CONCLUSION

While we are still in the midst / end of the financial crisis, there is a light at the end of tunnel and gradually, more optimistic sentiments will return to the market. However, there are a few lessons to be learnt and it is important for the market players to realize the mistakes that they have made and take corrective actions to reduce the probability of another crisis. (2)

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