



الوكالة الإسلامية الدولية للتصنيف  
Islamic International Rating Agency

# **Islamic Banking**

## **Supervision – Capital Adequacy – Risk Management**

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**BIBF, Kingdom of Bahrain**

**“Developing Rating Methodologies  
& Highlighting Challenges”**

By:

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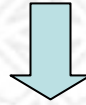
Chief Executive Officer

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# **Achieving Economic Development & Poverty Alleviation**

**Vibrant financial markets**



**Efficient allocation of financial resources**



**Economic growth**



**Job creation & Poverty alleviation**

**The efficiency of financial markets is marred by information asymmetry between lenders and borrowers.**

# Credit Rating & Its Role

- A rating is an independent, informed, objective opinion regarding the relative likelihood of default on a financial obligation.
- Eliminates the information asymmetry by providing an independent opinion on debtor's risk profile through a simple code.
- Rigorously analyzes the past, present and probable future.
- The independence and neutrality is of utmost importance.



# Benefits of Credit Rating Culture

- Enhances the transparency of financial markets.
- Provides basis for well-informed investment decision making.
- Induces an organization's management to improve internal practices to earn superior ratings and save financial costs.
- Assists regulators in bringing stability in the financial system.



# Emergence of Regional Rating Agencies

- The global rating agencies are mostly concentrated in USA and Europe.
- In many instances, the countries outside USA and Europe felt that the global rating agencies were often biased, remote and expensive.
- Hence, the need for regional rating agencies grew, and they started emerging during late 1980s.
- Regional rating agencies started in Japan and then spread in other big economies like India, China and Malaysia.



# IIRA Recognition as ECAI by CBB

- Islamic International Rating Agency (IIRA) was established with the support of Islamic Development Bank.
- IIRA became operational in July 2005.
- IIRA aims to play its role in the development of the regional financial market by providing an independent assessment and opinion on the likelihood of timely payment of financial obligations by sovereigns, corporates, banks and financial institutions and securities issued by governments, corporates, banks and financial institutions.
- IIRA is recognized as ECAI by CBB.

# IIRA's Competitive Advantages

- A legitimate alternative to the international agencies, one that knows the region.
- The mission of IIRA is to help issuers and investors by showing their strengths and weaknesses so they can work on them internally as ratings will not necessarily be made public, only if the client agrees.
- IIRA uses a national scale as well as international scale rating.
- IIRA offers Shari'a Quality Rating (SQR), a qualitative assessment of processes of Shari'a compliance by an entity.



# Independence of IIRA's Rating Committee (RC)

- It is ensured that Rating Committee members are completely independent and have no conflict of interest with the rated entity or rated instrument.
- RC comprises of IIRA's internal executives and analysts and external experts for all ratings other than SQR.
- For SQR, RC comprises of 3 independent scholars selected from our panel of nineteen scholars.



# IIRA's Services

IIRA offers the following:

- Sovereign Ratings
- Credit Ratings
- Shari'a Quality Ratings
- Corporate Governance Ratings



# Sovereign Rating Methodology

**IIRA evaluates the creditworthiness of the government of a country, determining its ability and willingness to fully service its financial obligations on time.**

**Sovereign Rating criteria are:**

- Politics and Policy Continuity
- The Economy—Structure and Growth Prospects
- Budgetary and Fiscal Policy
- Monetary Policy and Flexibility
- The External Accounts
- Internal and External Debt



# Banks Credit Rating Methodology

**IIRA's bank ratings measure the borrower's capability, willingness and likelihood of meeting its short and long term obligations**

**Bank rating criteria are:**

- 1. External Environment:** includes economic scenario, macroeconomic stability, diversity of sectors, political setting, stability & reforms, and alignment with economic policies.
- 2. Industry Environment:** includes industry lifecycle, regulatory oversight, competitive dynamics, and customer Power.



# Banks Credit Rating Methodology- Cont'd...

## 3. Internal Environment:

- **Capital:** assesses growth of capital, hidden reserves, and regulatory requirements to ensure adequacy of capital.
- **Asset Quality:** is assessed using portfolio stratification and concentration data.
- **Management:** evaluates historical performance and track record, mission and vision, competence, internal controls, experience in crisis management, planning & budgeting procedures.
- **Earnings:** assesses Contribution of core businesses to the bottom line, Diversification of earning streams from various business lines, The structural balance in re-pricing of assets and liabilities, and Level of profit distribution to the investment account holder as compared to market returns
- **Liquidity:** is performed using combination of ratios and qualitative criteria.
- **Sensitivity to Market Risks:** reflects the degree to which changes in interest rates, foreign exchange rates, commodity prices, or equity prices can adversely affect a financial institution's earnings or economic capital.



# Insurer's Financial Strength Rating Methodology

**An Insurer's Financial Strength Rating (IFSR) is an assessment of the insurance company's financial strength and its capacity to meet obligations to policyholders and contracts.**

**IFSR criteria are:**

1. **Qualitative Factors** - analysis of the insurance company's country risk and business profile.
  - **Country Risk**
    - Corporate and political governance
    - Economic environment
    - Insurance environment
  - **Business Profile**
    - Business plan and strategy
    - Management
    - Operational controls
    - Quality and appropriateness of reinsurance program



# Insurer's Financial Strength Rating Methodology – Cont'd...

## **2. Quantitative factors** - analysis of the company's balance sheet strength and operating performance

- Balance Sheet Strength
  - Capitalization
  - Adequacy of reserves
  - Quality and diversification of assets
  - Liquidity
- Operating Performance
  - Profitability



# Shari'a Quality Rating Methodology

- Shari'a Quality Rating (SQR) is aimed at providing information and independent assessment regarding the compliance processes of Islamic financial institutions or conventional institutions providing Islamic banking and financial services, as well as Islamic financial products such as Sukuk.
- IIRA aims to become a reference on which investors and financiers can rely to achieve “Quality” in terms of compliance with the related Shari'a rules and principles for financial services marketed as “Islamic”.
- Shari'a Quality Rating is not related to the solvency or financial capability of the institution, or to the credit quality of securities or financial products.



# Shari'a Quality Rating Methodology - Cont'd...

SQR Criteria are:

- Shari'a Committee
- Internal Shari'a Control
- Accounting Standards
- Training and Human Resources
- Zakat
- Social Impact
- Modes of Financing
- Identity and Corporate Image
- Other Considerations



# Corporate Governance Rating (CGR) Methodology

## IIRA's Corporate Governance Methodology

measures an entity's corporate governance practices and the extent to which it complies with regulations and guidelines of the regulators and the global 'best practices'.

### CGR criteria are:

- Regulatory Compliances
- Ownership Structure
- Board & Executive Management Structure & Processes
- Transparency
- Control & Discipline
- Stakeholders' Relations



# Challenges Faced by IIRA

- Achieving acceptance for its analysis, report and ratings in the Islamic capital markets and then globally.
- Building investor confidence in the ratings issued by it.



# Thank You

Please visit our website [www.iirating.com](http://www.iirating.com) for information on rating methodologies and rating scales

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