



Risk Management, Ratings and Information Asymmetries: Setting The Right Incentives for Systemic Stability

**Panel contribution by
Jermyn P. Brooks
Chair, TI Business Advisory Board**



What went wrong?

**1. A failure of risk management
resulting in inadequate transparency**



**2. A failure of corporate responsibility
= a lack of real commitment to
CSR and sustainability**





Who was responsible?

- all of us at this conference
- investors
- investment bankers
- intermediaries
- traders
- regulators
- auditors
- rating agencies

linked by a combination of greed and herd instinct





What reforms can prevent a repetition?



Strong parallels between auditors and rating agencies:

Both needed by all capital market players to provide objectivity and raise confidence in information provided

BUT

Both paid by those needing a favourable outcome from their services

For both this results in perceived or actual conflicts of interest and wrong incentives for systemic stability





Reforms of the audit profession post dot.com bubble

- Restrictions on consulting services to audit clients
- Disposal of consulting practices
- Strengthened regulation by new oversight boards of internal procedures, quality control and technical performance
- Enhanced focus on harmonised accounting principles with wider consultation processes
- Improved rules to avoid conflicts of interest



Proposed reforms of rating agencies a comparison

- No consulting services for companies they rate
- Compulsory registration and regulatory supervision
- More disclosure of how ratings are determined
- Stricter rules to avoid conflicts of interest



Are the proposed reforms sufficient?

Have not dealt with the fundamental conflict of interest:

Need to disconnect direct payment for services from immediate users and realign interests with investors and beneficiaries.

How? A suggestion:

Draw a parallel from US equity research settlement - Vary pay based on extent of investigation required and accuracy of ratings over a period.





THANK YOU!

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<http://transparency.org>

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