Media Release

An S&P Global Ratings Report Discusses The Misuse Of Proxy Ratings In Taiwan's Investment Market

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Current regulations are likely to create confusion and underestimate and distort credit risk in Taiwan's investment market, according to the report titled, "**Taiwan's Regulatory Requirements Run Contrary To Global Practice And Conceal Investment Risk**" that published by S&P Global Ratings through its subsidiary Taiwan Ratings Corp.

Issuer credit ratings and issue credit ratings are different assessments of credit risk and are not interchangeable, yet Taiwan stands alone as the only jurisdiction worldwide allowing issuer credit ratings to be used as proxies for issue credit ratings. Indeed, some jurisdictions, including Hong Kong, explicitly state that issue credit ratings and issuer credit ratings are not interchangeable for investment purposes.

Since 2013, Taiwan's financial regulator has been gradually easing regulations governing corporate bond and financial debenture issuance, with the intention of enhancing funding efficiency, reducing costs, and encouraging greater issuance volume—a move that we fully support. However, while deregulation has reduced costs for issuers it has not led to the increase in issuance volume that the removal of compulsory ratings and subsequent lower issuance cost could have produced. On the contrary, there has been much slower growth in new issuance volume for bonds and debentures during the past few years of deregulation despite Taiwan's gradual economic recovery over the same period.

S&P Global Ratings views recent the nature of recent deregulation in Taiwan as debatable because issuer credit ratings and issue credit ratings measure different aspects of credit risk. An issuer credit rating reflects a rating agency's opinion of the likelihood that an entity might default with regard to all its financial obligations, whereas an issue credit rating reflects our assessment of a blend of default risk and the priority of a creditor's claim in bankruptcy associated with the specific debt being rated. It is therefore an issue credit rating that investors need to evaluate in their investment decision making. We believe an unrated debt should be listed as such, reflecting its true status and risk, while the purchase of such debt is left to the discretion of investors.

In our view, the substitution of issue credit ratings with issuer credit ratings, a situation known as 'proxy ratings', not only leads investors to underestimate the embedded risk of their investments but also creates a loophole allowing investors to assign a lower capital charge on their subordinated debt than what should be applied if the debt was rated. That is because in our experience, issue credit ratings on subordinated debt are usually at least two notches below the long-term issuer credit rating on the obligor.

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We believe that markets and investors operate more efficiently and effectively under a consistent regulatory framework; therefore the direction in which Taiwan's regulatory regime is developing, contrary to established and accepted global practices, could stifle the market's attractiveness to inward investment and distort risk. We look forward to the establishment of an investment market in Taiwan that is both efficient and truly capable of reflecting investment risks.

The full report is available to our subscribers at **rrs.taiwanratings.com.tw** and for members of the press by contacting our media liaison, Simon Chen at +886-2-87225871 or simon.chen@taiwanratings.com.tw.

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