Dear Sirs,

BlackRock is pleased to have the opportunity to respond to IOSCO’s Consultation Report ‘Sound Practices at large intermediaries: Alternatives to the use of credit ratings to assess creditworthiness’.

BlackRock is a leading provider of asset management, risk management, and investment advisory services to institutional, intermediary, and individual clients worldwide. On behalf of its clients, BlackRock manages equity, fixed income, cash management, alternative investment and multi-investment and advisory strategies including the iShares® exchange traded funds.

BlackRock represents the interests of its clients by acting in every case as their agent. It is from this perspective that we engage on all matters of public policy. BlackRock supports policy changes and regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analysis, preserves consumer choice.

BlackRock is supportive of the development of a set of guiding principles on the use of credit ratings by large intermediaries, and find that most of IOSCO’s draft “sound practices” are broadly aligned with BlackRock’s existing approach to credit analysis, and the management of counterparty credit risk in our client portfolios.

In particular, we agree with the underlying principle that intermediaries must not rely solely on external credit ratings for assessing the creditworthiness of assets. While the utility of credit ratings as a common language and a standardised opinion of credit risk is important and should be preserved, they should be considered as one input among many, within a comprehensive, internal, credit analysis function.

We are, however, conscious, that the draft sound practices are intended to cover a broad range of market participants – from banks, to asset managers, and other large intermediaries – all of whom have different business models, and are therefore likely to look at creditworthiness in different ways and for different purposes.

For example, we observe that several of the sound practices (e.g., 4 and 5) appear to originate from the perspective of a firm conducting proprietary trading functions or managing portfolios for its own account (for example, a bank or insurance company), and as such itself exposed to credit risk. In contrast, in the case of an asset manager such as BlackRock, all portfolios are managed on behalf of clients, who confer on BlackRock investing teams a mandate to invest in credit asset classes and it is the client that is exposed to credit risk.
Acting as an agent on behalf of others to execute different investment strategies means that asset managers will use credit assessments, and manage the credit assessment process, in different ways. For example, where an asset manager is managing a cash portfolio with very strict investment guidelines pertaining to counterparty credit risk, all of the combined principles might be considered best practice. However, when pursuing other types of investment mandates where credit risk is one variable in an investment decision, not all the principles (for example, those relating to the separation of analysts from other functions) might be in line with the role of credit assessment in that particular mandate.

Additionally, some of the draft sound practices refer to the use of ratings as they relate to credit analysis as part of the investment process, and others to counterparty credit risk management. In order for the sound practices to be broadly applicable, we recommend that the final wording be clarified to address these different scenarios.

1) The use of credit ratings in credit analysis

We agree that rigorous fundamental credit analysis is integral to the credit investment process, and that this expertise should be in-house. As such, we rely on our own credit analysis when making credit investment decisions for our client accounts, which incorporates both quantitative and qualitative factors.

- Credit analysis in partnership with trading and portfolio management functions
  
  In our view, fundamental credit research is an integral and inseparable part of the credit investment process. It operates in partnership with trading and portfolio management functions, and credit investment decisions should be jointly underwritten by dedicated teams made up of these three units. We therefore do not agree that the credit assessment function, as it relates to investment decisions, should be separate in all instances.

- Credit analysis processes tailored to asset class
  
  BlackRock maintains separate investment teams for investment grade and non-investment grade credit classes (e.g. Leveraged Finance and Credit Alternatives), which include dedicated analysts. However, we do not believe that a simple bifurcation of analysis on the basis of investment and non-investment grade credit meets the underlying objective of ensuring appropriate assessment. Ultimately, the goal should be to ensure that analysis processes are appropriately tailored to each type of asset class, rather than to mandate enhanced scrutiny for certain classes, based on their credit rating alone.

2) The use of credit ratings in the management of counterparty credit risk

With respect to the use of credit ratings in the management of counterparty credit risk, BlackRock has a dedicated counterparty and concentration risk team that conducts reviews of the creditworthiness of all counterparty legal entities before trading, and monitors these counterparties on an ongoing basis. Our review process incorporates a variety of quantitative and qualitative factors. In line with the established approach to managing counterparty credit risk at BlackRock, we agree that credit assessment, as it relates to the management of counterparty credit risk, should be a function clearly separated from business units where trade execution, portfolio management or client relationship decisions may be taken.

Sound practices 5 (if re-phrased to apply to a wider range of market participants), 7 and 11 combined can be viewed as a best practice in an investment management firm when considering establishing counterparty risk management policies and procedures related to the review and approval of trading counterparties, as well as the on-going oversight of exposures at the client portfolio level.
In conclusion, our recommendations for the final draft of the sound practices can be summarised as follows:

- Differentiate between investment mandates and counterparty risk management in the use of credit ratings in credit analysis

- Ensure sufficient flexibility for the principles to be applicable to diverse intermediary business models, and clarify where practices are not pertinent to asset managers

- Tailor credit analysis processes by asset class and client mandate, not external credit grade

We would also highlight that credit processes require the flexibility to evolve, to reflect changing market dynamics and the many qualitative factors that play an important part in credit analysis. The final wording of sound practice 13 should reflect this.

We appreciate the opportunity to comment on the consultation report and welcome further discussion on any of the points that we have raised.

Yours faithfully,

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