

Out of the Ivory Tower: Scope Invites Analytical Feedback from Investors on Rated Issuers



Aiming for enhanced transparency and interactivity in its rating assessment process, Scope Ratings is breaking the mould of the long-entrenched modus operandi of the large incumbent rating agencies. Specifically, it is inviting institutional investors to provide their analytical views on rated debt issuers.

The Investor Analytical Feedback (IAF) – in the form of straightforward and simple answers to short issuer-specific analytical surveys provided by Scope – will achieve several important outcomes:

- Engaging the investor community in Scope Ratings' analytical process will address a recurring market criticism about rating agencies being excessively inward-looking and too indifferent to rating users' own credit concerns ('they operate in an ivory tower'). That said, as much as rating users' views on the credit fundamentals of an issuer tend to be 'food for thought' for Scope's analysts, they would not represent in any way a rating input (*see the Q&A section below*).
- Involving expert views from investors on specific rated issuers will represent a novel and powerful catalyst for a rating agency's analytical transparency and should end up being appreciated by the investor community and market participants. If properly pursued, the IAF may over time become a more widespread feature in the credit rating industry. Scope's willingness to invite independent views from investors is visibly the opposite of an ivory-tower culture.
- Offering a wider view on the mix of credit strengths and challenges displayed by their business and financial fundamentals is likely to be regarded positively by rated issuers as well. Scope analysts will share and discuss the analytical survey template with the respective rated issuer before distributing it to investors for analytical feedback. Scope will also share with the respective rated issuer, on an aggregate and strictly no-name basis, the main analytical takeaways from the investor feedback.
- When relevant, and with the above caveats in mind, key takeaways from the IAF will be included in issuer-specific analytical reports. They will also represent useful building blocks in more general reports regarding market views on specific themes or geographies and should benefit investors, issuers, and other market participants alike.
- Periodic investor feedback to the rating analysis – even though not as an input for the rating itself – may help mitigate potential concerns (mostly from investors) related to rating agencies' 'issuer pays' business model by adding an 'investors pay attention' counterbalance.

The Q&A section below explains the main features of Scope's IAF.

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Benefits of Scope's Investor Analytical Feedback (IAF)

| Investors | Issuers | Rating Industry |
|---|---|--|
| Addresses frequent criticism that rating agencies are excessively inward-looking and too indifferent to investor concerns | Offers a wider range of views on the issuer's business and financial fundamentals | IAF's enhanced transparency and interactivity is the opposite of an ivory-tower culture |
| Supplements rating analyst assessment with institutional investors' own views on rated debt issuers | Provides rated issuers with aggregate takeaways on investor views (on a strictly no-name basis) | Inviting investor views could provide an 'investor pays attention' counterbalance to rating agencies' 'issuer pays' business model |

Q&A on the Investor Analytical Feedback

Q1: What is Scope's Investor Analytical Feedback and how is it pursued?

Scope's credit analysts will periodically call for analytical feedback from investors on key credit issues related to specific issuers rated publicly by Scope. Feedback entails replies to a short analytical survey sent by Scope to institutional investors likely to be highly familiar with the respective issuer. The expected respondents would be the investment firm's specialised analysts or portfolio managers.

The analytical survey consists of 10-12 multiple-choice questions and will require no more than 10-15 minutes to reply (mostly in a straightforward agree/disagree format). The questions address topics, themes or metrics related to the business and financial characteristics of the issuer or to broader developments, as well as opinions attached to these. The survey's questions and expected answers are derived entirely from public information which the invited respondents normally have their own independent access to and knowledge of. A sample survey is attached in the Appendix.

Q2: Is Scope inviting other market participants to respond to the IAF surveys?

As its name suggests, the IAF is designed solely for institutional investors as Scope is interested in their independent credit views on specific rated issuers. Survey replies will normally not be solicited from other categories of market participants (such as DCM teams, intermediaries, consultants, sell-side analysts, and other issuers).

Scope is already engaging in different ways with broad categories of market participants, for example, through research and ratings, analyst presentations, meetings, and active participation at conferences.

Q3: How often will IAF surveys be sent?

The aim is to send IAF surveys to investors at least once a year. However, if issuer- or sector-specific developments warrant updated feedback, Scope analysts will aim to do it more often. But, in general, we acknowledge the time and effort this would demand from investors – even if the survey is short and straightforward.

Q4: Which credit sectors will be covered by the IAF?

In our view, the IAF generally adds more value when the issuers are covered by fundamental ratings for which a material amount of public information is readily available to investors and market participants. Such issuers include large banks and other financial institutions, large non-financial corporates, and public-sector bodies.

The first stage of Scope's IAF strategy will focus on publicly rated banks.

Q5: Is there a minimum critical mass of investor replies necessary for the output of IAF surveys to be considered in public communications?

We consider that a minimum critical mass of investor replies is indeed required for the output of issuer-specific IAF surveys to be considered in public communications – reference on a no-name aggregate basis in issuer-related reports or other general research (see *answer to Q7 below*). In general, the critical mass minimum for survey replies should be in function of the market profile of the respective issuer (debt issuers which are frequent issuers in the market inherently attract interest from a larger number of investors).

Anything less than what we could consider a minimum critical mass may not be representative enough to justify drawing key takeaways on an aggregate basis.

Q6: What is the rated issuers' involvement with the IAF?

The rated issuers which are the subject of the respective IAF survey will receive from the Scope analyst the survey template with the questions, before it is sent to investors for feedback. The issuers will thus have the possibility to opine on the accuracy of the proposed survey questions, and to check they are based on public information which is thus independently available to investors as well.

That said, the issuers will not have the option to veto survey questions which they disagree with analytically.

Scope analysts will also engage with the issuers regarding the key takeaways from the survey responses. This will be done solely on an aggregate and strictly no-name basis. The only exception would be if a responding investor specifically authorises Scope, in writing, to share the replies and/or its name with the respective issuer, and this would only be done for that particular survey.

Q7: Could investor replies differ – individually or even on aggregate – from Scope's analyses?

While not the most likely outcome, this scenario cannot be excluded. For example, differences of view may arise because Scope's rating analysis is based on its own methodology, while various institutional investors may assign different weights to various credit-analysis criteria, thus leading to potentially different angles.

In fact, the scenario of an investor's view – as reflected by replies to the survey – not fully coinciding with Scope's own analytical narrative on a specific issuer strengthens the argument for the IAF initiative, as it provides transparency on alternative opinions (but not on alternative facts) for the benefit of both investors and issuers.

Q8: Is there a link between the IAF initiative and Scope's rating process?

The IAF initiative and Scope's rating process are in no way related and do not interconnect. Rating and rating-outlook actions – new assignments, reviews, changes, withdrawals – are the outcome of the Scope rating committee's independent decisions and are based on rating recommendations presented by the lead analytical team. These recommendations are anchored in Scope's independent analysis, based on Scope's own rating methodology applicable to the respective credit segment, and which does not include alternative opinions from third parties.

Scope will not be inviting investor feedback in relation to any rating action, nor will it do so in relation to portfolio reviews which may result in rating affirmations or proposals for subsequent rating actions. The timing of the IAF surveys being sent to investors during the year is no way connected to the timing of rating actions or portfolio reviews.



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Q9: How will the IAF survey's output be used by Scope?

Again, Scope will discuss the key takeaways from the IAF survey with the respective issuer, but only on the criteria highlighted in the answer to Q6 (*above*).

Assuming the criteria highlighted in the answer to Q5 are met, Scope will also include these key takeaways in the respective issuer reports – but not as part of rating drivers or rating-change drivers.

The key takeaways from IAF will also represent useful building blocks in more general reports regarding market views on specific themes or geographies and thus should benefit investors, issuers, and other market participants alike.

Q10. When will the IAF initiative start?

Scope expects IAF surveys to start being sent out gradually from the end of the first quarter of 2018.



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Appendix: Investor Analytical Feedback (IAF) Survey Sample:

Bank Alphabravo Charlie (Bank ABC)

1. Continuing to grow as a globally diversified banking and financial services group, with a balanced spread across developed and emerging markets, will remain Bank ABC's business model for the foreseeable future.
 - ☐ Agree
 - ☐ Somewhat agree
 - ☐ Neither agree nor disagree
 - ☐ Somewhat disagree
 - ☐ Disagree
 - ☐ No opinion
2. In the event of non-organic growth, Bank ABC will prefer to (a) consolidate in existing geographic markets, (b) initiate M&A in new geographic markets, or (c) both.
 - ☐ Existing geographies
 - ☐ New geographies
 - ☐ Both
 - ☐ No opinion
3. The Fredonia market may weaken further, thus materially affecting an important component of Bank ABC's global earnings power.
 - ☐ Agree
 - ☐ Somewhat agree
 - ☐ Neither agree nor disagree
 - ☐ Somewhat disagree
 - ☐ Disagree
 - ☐ No opinion

4. **Centrifugal material stresses developing in the Lalaland economy may hurt Bank ABC's global earnings power and asset quality.**
- ☐ Agree
 - ☐ Somewhat agree
 - ☐ Neither agree nor disagree
 - ☐ Somewhat disagree
 - ☐ Disagree
 - ☐ No opinion
5. **With regards to the recent acquisition of Bank DEF, and considering the transaction as well as the related capital increase... (tick the sentence you agree most with):**
- ☐ The deal is positive as it gives Bank ABC a needed boost in its home market where it was falling behind peers in terms of franchise power.
 - ☐ The deal is positive: Bank ABC got solid future earnings for free.
 - ☐ The deal is negative as potential legal risks are material.
 - ☐ The deal is negative as downside risks on asset quality remain relevant.
 - ☐ The deal is neutral as the risks arising from the transaction are overall balanced.
6. **Domestic macro and sovereign-related negative trends would hurt Bank ABC's performance, also the market sentiment related to it.**
- ☐ Not likely
 - ☐ Not unless these trends are material and not easily reversed
 - ☐ Not necessarily as Bank ABC displays a highly diversified earnings and balance-sheet mix, well equipped to withstand negative cycles in specific geographies
 - ☐ The bank's management is forward-looking and anticipative so the group should remain safely ahead of the curve unless there is a sudden, massive downturn
 - ☐ Despite geographic diversification, Bank ABC remains vulnerable to domestic market weaknesses



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7. **Bank ABC's management strategy has over the years displayed a reassuring mix of well-timed alternation of assertiveness and caution; we expect this approach to continue.**

- ☐ Agree
- ☐ Somewhat agree
- ☐ Neither agree nor disagree
- ☐ Somewhat disagree
- ☐ Disagree
- ☐ No opinion

8. **Following last quarter's new equity issuance Bank ABC's CET1 ratio strengthened to 12.5% which is slightly below the average of large peers. We view this as an optimal level of capital for the banking group.**

- ☐ Agree
- ☐ Somewhat agree
- ☐ Somewhat disagree
- ☐ Disagree
- ☐ No opinion

9. **The bank's liquidity position improved significantly during the last six quarters and management seems to be committed to preserving and improving the funding balance. Reliance on stable retail deposits is reassuring.**

- ☐ Agree
- ☐ Somewhat agree
- ☐ Somewhat disagree
- ☐ Disagree
- ☐ No opinion



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10. Bank ABC's supervisory framework and assigned prudential metrics are reassuring for the group's safety and predictability.

- ☐ Agree
- ☐ Somewhat agree
- ☐ Somewhat disagree
- ☐ Disagree
- ☐ No opinion

11. Any other positives, negatives or relevant areas of consideration you wish to highlight:

- ☐ _____
- ☐ _____
- ☐ _____
- ☐ _____
- ☐ _____
- ☐ _____



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