

Core Ratings

Governance and
Responsibility
Ratings



Core Ratings: a sister company to Fitch Ratings

- ✍ Fitch Ratings is one of the world's largest rating agencies
 - 1,200 staff in 40 countries
- ✍ **Core** Ratings is a sister company to Fitch Ratings
- ✍ **Core** Ratings focuses on governance and responsibility
- ✍ **Core** Ratings research is used by the world's largest asset managers:
 - Clients control \$1,500 billion in investment assets

Experts in the analysis of corporate governance and corporate responsibility

- ✍ Corporate Governance research and ratings
- ✍ Corporate Responsibility research and ratings
- ✍ Coverage of around 1,000 companies
- ✍ Sector themes and investment issue analyses
- ✍ Company Engagement:
 - Researching, structuring and facilitating active dialogue between companies and their shareholders on key issues

What are Qualitative Risks?

- ✍ All business risks of a primarily non-financial nature that have a material financial impact
- ✍ Core Ratings group these under two main areas:
 - Corporate Governance
 - Corporate Responsibility

Qualitative risks impact all parts of the financial markets

- ✍ Materially affect the prices of financial assets:
 - Equity and bond valuations
 - Availability and pricing of credits and insurance cover
- ✍ Becoming the subject of intense regulatory overlay
- ✍ Part of the responsibilities of underwriters/lead managers in bringing new issues
- ✍ Financial services companies are increasingly likely to become party to law suits
- ✍ High chance of suffering collateral reputation damage

Value is about confidence and risk management

Corporate Governance = building trust with investors

It demonstrates that the Board of Directors:

- ✍ Is competent to manage the business
- ✍ Has organised the business logically and efficiently
- ✍ Is complying with all external laws and codes
- ✍ Is running the business in the interests of the financial stakeholders
- ✍ Is disclosing promptly and accurately all information material to stakeholder decisions

Value is about confidence and risk management

Corporate Responsibility = managing business risks

It demonstrates that the Board of Directors:

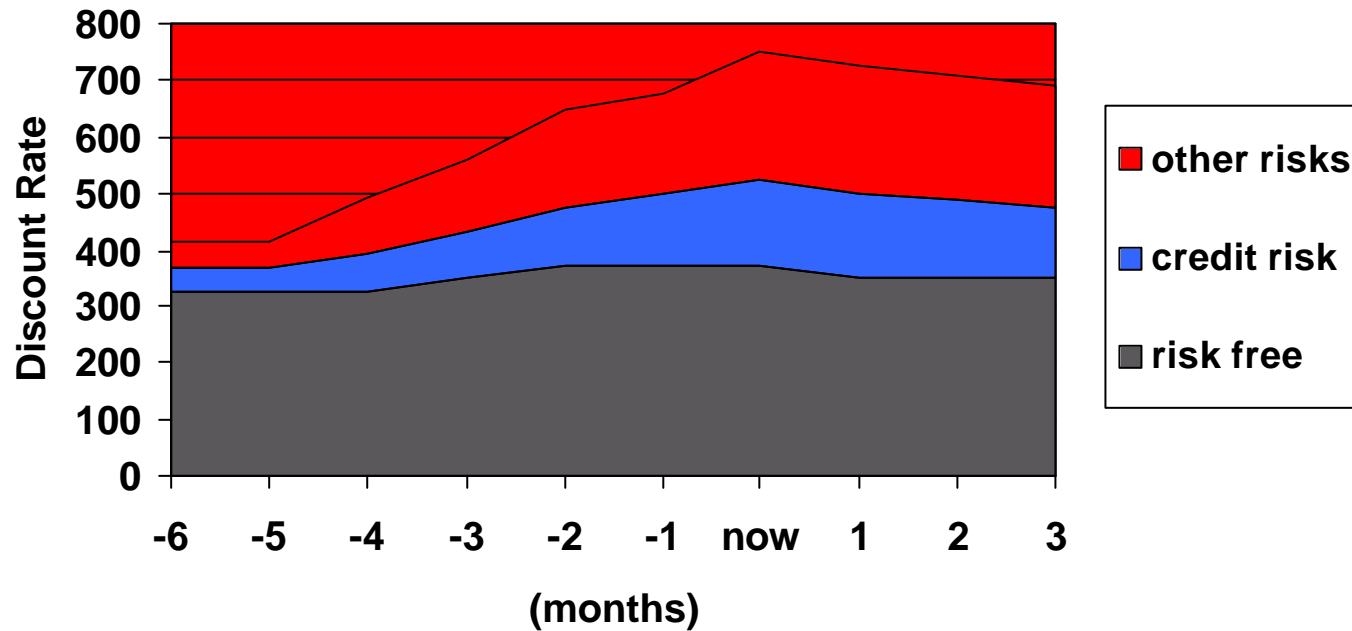
- ✍ Is analysing the key business, operational, environmental and social risks
- ✍ Is mapping those risks against their effect on investment values
- ✍ Is developing, implementing, monitoring and disclosing robust policies to control those risks

Qualitative risks influence the NPV of financial assets

- ✍ All financial assets are represented by a stream of earnings or cash flows
- ✍ These are discounted back to arrive at their NPV
- ✍ The discount rate represents the ‘required return’ for holding that asset:
 - Yield to maturity for a bond investment
 - IRR on an equity investment
- ✍ It is a direct measure of RISK
- ✍ Companies with low RISK have a lower cost of capital

Discount rate is a measure of risk

Typical Financial Asset



Regulators have picked up the message on risk

- ✍ Sarbanes-Oxley is about corporate governance and the control and reporting of material business risks
- ✍ Similar concepts underpin the UK's combined code
- ✍ UK looking at mandatory reporting of CSR risks, possibly through an 'operating and financial review'
- ✍ Environmental and social reporting becoming mandatory in France
- ✍ Various regional stock exchanges considering mandatory governance ratings to reduce overall market risk premiums
- ✍ Non-compliance is itself a material investment risk

Qualitative risks are a central concern in bringing new issues

- ✍ Equity and debt markets effectively shut
- ✍ Therefore even more responsibility on lead managers:
 - Due diligence: must cover governance and responsibility issues
 - Prospectus: must have informed analysis of qualitative risks
 - Research: fair and balance
 - Pricing: these days has to be based on fundamental analysis
- ✍ By analysing qualitative risks, lead managers can:
 - Improve the chance of getting their issue away
 - Avoid subsequently being sued for non-disclosure of material risks

Qualitative risks becoming very important in pricing credit and insurance provision

- ✍ Leading commercial banks and insurance companies are taking a hard look at qualitative risks:
 - Helps identify risk areas during credit/underwriting analysis
 - Helps to determine structure and pricing of risk
 - Demonstrates to own stakeholder community commitment to sound responsibility principles
- ✍ Banks and insurers are increasingly likely to be sued for the activities of companies they finance:
 - The consistent analysis of qualitative risks can help avoid/alleviate these liabilities

The final word!

- ✍ A detailed analysis of qualitative (governance and responsibility) risks can:
 - Improve returns by better understanding pricing and value
 - Lower investment, credit and insurance portfolio risks
 - Provide positive reinforcement of your own corporate values
 - Reduce the likelihood of becoming party to law suits in respect of the activities of clients
 - Help to avoid collateral reputation damage
- ✍ Core Ratings are leading experts in the analysis of qualitative (governance and responsibility) risks