

# FAILING GRADE

Can rating agencies handle structured products?



Investors have for decades relied on rating agencies like DBRS to help them judge the soundness of their investment choices. But the ability of credit rating agencies to provide

adequate quality control is coming under fire for the second time since the WorldCom and Enron debacles of just a few years ago. As the subprime market unravels, taking with it the market for asset-backed commercial paper (ABCP) products in Canada, you've got to wonder whether or not rating agencies are up to the job of actually assessing the risk of these investments. Not that it's easy. ABCP products are made up of a bunch of different loans packaged by banks and other financing companies and sold off to spread the risk in case the loans aren't repaid. The structures are complex and transparency can be a major challenge.

Which is why investors rely on credit rating agencies—without their seal of approval, these products would be tough to sell. But sell they did—with the help of DBRS in Canada, the market for ABCP products thrived as institutional investors used them to park money at better

rates than they'd get from T-bills. It all seemed like a safe thing to do, given that DBRS had pinned consistently high ratings on these products.

With investors relying on rating agencies to assess the risk of complicated structured finance products like ABCPs, it's time to ask whether or not these agencies are up to the task, particularly as these investments become more and more complicated. Canadian investors—particularly plan sponsors and the plan members they serve—deserve a lot better than what they've been served up so far.

With more trouble looming on the horizon as a result of problems in the U.S. mortgage market, plan sponsors will be looking for reliable and relevant data to steer them in the right direction. As rating agencies like DBRS review their criteria, investors are going to have to ask tough questions about their practices going forward. Whether these agencies will have the answers they need is another story. ■

— Caroline Cakebread

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