

REPUBLIC OF THE PHILIPPINES
GOVERNMENT PROCUREMENT POLICY BOARD
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NPM No. 34 - 2004

March 22, 2004

HON. VICKIE G. MENDOZA
Director
Department of Finance ("DOF")
Roxas Boulevard Cor. Pablo
Ocampo St., Manila

Re : **Procurement of the Services of a Credit Rating Agency
("CRA")**

Dear Dir. Mendoza:

This refers to your letter dated January 13, 2004, which we received through facsimile on January 16, 2004, requesting for advice as regards the method of procurement to be utilized in procuring the services of a Credit Rating Agency ("CRA"), including the proper procedure to be undertaken in the procurement thereof.

Nature of Credit Rating Agencies

Credit rating is basically "an assessment of how likely an issuer is to make timely payments on a financial obligation". (International Organization of Securities Commission Report, September 2003, p. 3) Accordingly, a CRA is primarily concerned with assessing the credit risk of corporate or government borrowers and issuers. As such, the CRA definitely plays a significant role in many domestic and international transactions by enabling investors to make informed decisions through the analysis of vast amounts of raw data available regarding an issuer or borrower. If the investors believe in the existence of broad information asymmetries, they would typically insist on being compensated for the risk they take in the form of higher interest rates. Consequently, the value which investors give on the CRA's opinion inevitably depends on the reputation of the CRA itself. Although, such reputation may depend on several factors, the fact that the CRA's reputation for timeliness and accuracy is questionable would also reflect on the value which investors place on the reliability of the ratings they make.



As can be deduced from your letter, some CRAs are more likely to be trusted in the international scenario than others, such that some are more preferred and acceptable by a specific market while others can be considered as less favored, which brings about preference to Standard and Poor's ("S&P") and Moody's Investors Service ("Moody's") by US Based investors; Fitch Ratings, Ltd. ("Fitch") by the European Market; and, Japan Credit Rating Agency ("JCR") in Japan and Asian Region. Be that as it may, such fact does not negate the existence of numerous CRAs internationally, or to be more specific, in certain regions such as Europe, the United States and Asia. Clearly, in the procurement of the services of a CRA, it can be gainfully said that the crux lies not in the scarcity of CRAs in the market, but the preference and partiality of investors as regards the CRA they opt to trust. Consequently, the engagement of the services of a CRA will depend greatly on the target market, the *situs* or place of issuance of the bonds and the trusted CRA in that specific *situs* or locality.

Method of Procurement

In the international environment, in order to substantiate the credibility and financial soundness of the bonds set to be offered, the Philippines needs good credit ratings from CRAs trusted and relied upon by investors in the different financial regions. The rationale is not hard to comprehend, an affirmative rating simply opens the gateway for more investment opportunities for the country, the effects of which will be too many to enumerate. Alongside the above observations, it now becomes imperative for the Philippines to engage the services of the most known, trusted and relied upon CRA, one that is respected, valued and revered by investors in their respective *situs*, region or locality.

Looking at the peculiarity and uniqueness of the services being rendered by CRAs, compounded further by the serious implication and effect of its credit ratings in the international market as a whole, and to the country's economy in particular, the direct engagement of specific CRAs becomes inevitable due to the recognition, trust, dependence and reliance afforded to them by investors in the market. For this reason, we opine that the engagement of the services of CRAs, which we consider as procurement of goods and services, can be coursed through the alternative method of procurement known as "direct contracting" or "single source procurement". The legal anchor may be found in Section 50 (a) of the IRR-A of R.A. 9184, which provides, to wit:

Section 50. Direct Contracting

Direct Contracting or single source procurement is a method of procurement of goods that does not require elaborate bidding documents. The supplier is simply asked to submit a price quotation or a pro-forma invoice together with the conditions of sale. The offer may be accepted immediately or after some negotiations. Direct contracting

may be resorted to by concerned procuring entities under any of the following conditions:

- a) Procurement of items of proprietary nature which can be obtained only from the proprietary source, *i.e.* when patents, trade secrets and copyrights prohibit others from manufacturing the same item;

As already intimated, in regional markets only a specific CRA is recognized and accepted by investors due to the reputation, reliability and integrity it has created. Needless to say, this recognition and acceptance has its bases on the specific system, methodology, framework, structure, trade secret and discipline the CRA developed and practiced through the years, which are now considered and recognized as specific and relative only to a certain CRA, thereby making such approach/practice proprietary in character and nature.

In fine, since only a particular CRA is trusted and recognized in a specific area or region and only the rating of such CRA holds water or has more weight to investors within that jurisdiction, coupled by the proprietary character of the system, methodology, trade secret and discipline each adopts, the DOF may engage the services of the said CRA through direct contracting.

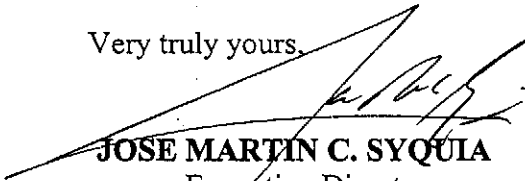
At this juncture, emphasis must still be made that in order to secure the desired competence of a CRA that will be acceptable to international investors, the DOF must prepare its criteria and technical specifications such that the end result will be the engagement of a CRA bearing the reputation and trustworthiness recognized by investors in a particular region.

Procedure for the Procurement of Services of CRAs

Applying Section 50 (a) of the IRR-A of R.A. 9184, the procedures in the procurement of CRAs do not require elaborate bidding documents, the DOF may simply request the selected CRA to submit a price quotation together with the conditions for the engagement of its services. The offer made by the selected CRA may be accepted immediately or after some negotiations, thereafter, the procuring entity may now award the contract to the CRA concerned.

Anent all the foregoing, it is hoped that your concerns were sufficiently addressed.

Very truly yours,


JOSE MARTIN C. SYQUIA
Executive Director
GPPB-TSO