

CONSULTATION PAPER

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Proposed Regulation of Credit Rating Agencies

MAS

Monetary Authority of Singapore

PROPOSED REGULATION OF CREDIT RATING AGENCIES

PREFACE

1 Following the recent financial crises, a strong consensus emerged within the G20 that there is a need to supplement industry codes and the internal controls of credit rating agencies (“**CRAs**”) with CRA regulation by national competent authorities. Following the G20’s call, the International Organisation of Securities Commission (“**IOSCO**”) added a new Principle 22 on the regulation of CRAs to the IOSCO Objectives and Principles of Securities Regulation (“**IOSCO Principles**”) as part of a broader revision of the IOSCO Principles. Major jurisdictions around the world have begun implementing regulatory regimes on CRAs.

2 In line with global developments, MAS is proposing to regulate activities conducted by CRAs under the Securities and Futures Act. It is proposed to require CRAs to be licensed under the Capital Markets Services (“**CMS**”) licensing regime and be subject to licensing obligations.

3 MAS invites interested parties to provide their comments and feedback on the proposals in relation to the proposed regulatory regime for CRAs to:

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10 Shenton Way
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MAS requests that all comments and feedback be submitted by 22 April 2011.

4 Please note that all submissions received may be made public unless confidentiality is specifically requested for whole or part of the submission.

1 INTRODUCTION

1.1 Credit rating agencies (“**CRAs**”) provide credit ratings on entities and securities that are widely relied on by participants in the securities markets and the banking industry. Credit ratings are also used for various regulatory purposes.¹ Consequently, CRAs play an important role in the capital markets and their rating activities have a significant impact on the operation of the markets and on investor confidence.

1.2 Following the recent financial crisis, a view has emerged among regulators that there is a need to further supervise CRAs to enhance the quality of ratings, safeguard the integrity of the rating process, and promote CRA independence and the avoidance of conflicts of interests.

1.3 In the *Declaration on Strengthening the Financial System* issued on 2 April 2009², G20 countries agreed that there is a need to supplement industry codes and CRAs’ internal controls with CRA regulation by national competent authorities. The G20 further agreed that all CRAs whose ratings are used for regulatory purposes should be subject to regulatory oversight that includes registration and is consistent with the *Code of Conduct Fundamentals for Credit Rating Agencies* (“**IOSCO CRA Code**”)³ issued by the International Organisation of Securities Commission (“**IOSCO**”)⁴.

1.4 In June 2010, IOSCO adopted a new Principle 22 on the regulation of CRAs into its Objectives and Principles on Securities Regulation (“**IOSCO Principles**”) as part of a broader revision of the IOSCO Principles.⁵ Principle 22 states that –

¹ For example, financial institutions may be permitted to rely on CRAs’ ratings on a security as part of net capital assessment and fund managers may be required to only include securities rated above a certain level in some types of funds.

² See http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf

³ See <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>

⁴ The IOSCO is a global association of securities regulators of which MAS is a member. The IOSCO’s objectives includes cooperation among this members to develop, implement and promote adherence to internationally recognised and consistent standards of securities regulation, oversight and enforcement in order to maintain fair, efficient and transparent markets.

⁵ See <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>

“Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.”

1.5 A number of jurisdictions have begun implementing regulatory regimes on CRAs:

- (a) **Europe** – The European Union (“**EU**”) introduced Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 (“**EU Regulation**”)⁶. Under the EU Regulation, CRAs operating in the EU must be registered and regulated under the EU Regulation in order that their crediting ratings may be used for regulatory purposes within the EU. Further, with effect from 7 June 2011, credit ratings issued by a CRA outside the EU can be used for regulatory purposes in the EU only if the CRA is registered under a regulatory regime that is recognised by the EU as “equivalent”; or the credit ratings are endorsed by an EU-registered CRA as complying with requirements that are “as stringent as” those under the EU Regulation.
- (b) **United States** – The Securities and Exchange Commission amended its rules with effect from 2 February 2010 to impose additional requirements to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the CRA industry⁷.
- (c) **Australia** – From 1 January 2010, CRAs operating in Australia are required to be licensed and be subject to licensing requirements under the Australian Financial Services (“**AFS**”) licensing⁸ regime and prescribed regulations in relation to credit rating activities.

⁶ See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0001:0031:EN:PDF>

⁷ See November 2009 Amendments to the Rules Relating to the Oversight of Nationally Recognized Statistical Rating Organizations at <http://www.sec.gov/rules/final/2009/34-61050.pdf>

⁸ See ASIC Information Sheet 99 at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/INFO99_CreditRatings.pdf/\\$file/INFO99_CreditRatings.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/INFO99_CreditRatings.pdf/$file/INFO99_CreditRatings.pdf)

- (d) **Japan** – The Japan Financial Services Agency revised the Financial Instruments and Exchange Act (with effect from 1 April 2010) to introduce a registration system for CRAs. The Cabinet Office Ordinance had also been revised in December 2009 to impose obligations on CRAs in respect of quality control in the rating process⁹.
- (e) **Canada** – In July 2010, the Canadian Securities Administrators (“**CSA**”) proposed a regulatory regime for credit rating organisations (“**CROs**”) based in Canada. The proposed regime will allow a CRO to apply for designation as a designated rating organization (“**DRO**”) so that their ratings can be used for regulatory purposes. Once designated, a DRO must establish, maintain and ensure compliance with a code of conduct that is on terms substantially the same as the IOSCO CRA Code¹⁰.
- (f) **Hong Kong** – The Hong Kong Securities and Futures Commission (“**HKSFC**”) proposed in July 2010 to regulate the “provision of credit rating services” as a regulated activity under the Securities and Futures Ordinance (“**SFO**”). Under this proposed regulatory framework, CRAs and their rating analysts will be subject to licensing obligations as prescribed under the SFO¹¹.

⁹ See the Guidelines for Supervision of Credit Rating Agencies at <http://www.fsa.go.jp/en/news/2010/20100331-4/07.pdf>

¹⁰ See Proposed National Instrument 25-101 at http://www.osc.gov.on.ca/documents/en/Securities-Category2/rule_20100716_25-101_designated-rating.pdf

¹¹ See the Consultation Paper Concerning the Regulatory Oversight of Credit Rating Agencies (19 July 2010) at <https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=rocra&type=1&docno=1> and the Consultation Conclusions Concerning the Regulatory Oversight of Credit Rating Agencies (29 October 2010) which is available at http://www.sfc.hk/sfc/doc/EN/speeches/public/consult/conclusions_cra_eng.pdf

2 REASONS FOR REGULATING CREDIT RATING AGENCIES

2.1 In view of the new IOSCO Principle 22 and the global trend towards regulating CRAs, it is necessary for Singapore to implement regulatory oversight of CRAs to conform to international standards and practices. This will ensure that Singapore remains an attractive location for CRAs to operate in.

3 PROPOSAL TO REGULATE CREDIT RATING AGENCIES THROUGH THE EXISTING CMS LICENSING REGIME

New regulated activity of “providing credit rating services”

3.1 We propose to regulate CRAs under Part IV of the Securities and Futures Act (Cap. 289) (“**SFA**”) by adding “providing credit rating services” as a regulated activity. Any person who carries on or holds himself out as carrying on the business of “providing credit rating services” will be required to hold a Capital Markets Services (“**CMS**”) licence under section 82 of the SFA.

3.2 To implement the regulation of CRAs under Part IV of the SFA, the Second Schedule to the SFA will have to be amended to add “providing credit rating services” as a new type of regulated activity in Part I and to add the definitions of “providing credit rating services” and other related terms in Part II. Consequential amendments to the SFA, and amendments to applicable subsidiary legislation in respect of prudential and business conduct requirements for this new regulated activity will have to be made.

3.3 **Appendix A** to this consultation paper sets out the proposed definitions of “providing credit rating services” and other related terms.

Proposed scope of “providing credit rating services”

3.4 We propose to define “credit rating” as “an opinion regarding the creditworthiness” of a rating target “expressed using a defined ranking system of

rating categories". We believe that this definition expresses the general understanding that a "credit rating" is an opinion on creditworthiness and not advice or recommendation concerning whether to buy or sell securities. It is also consistent with the definition of "credit rating" in the IOSCO CRA Code.¹²

3.5 The rating target within the definition of "credit rating" can be a person other than an individual, a government (including the Singapore Government), or securities. The meaning of the word "securities" will be as defined in section 2(1) of the SFA and will include "any debenture stock, bond note and any other debt securities issued by a corporation or any other entity, whether constituting a charge or not, on the assets of the issuer"¹³.

3.6 The proposed definition of "providing credit rating services" covers the preparing, whether partly or wholly within Singapore, of credit ratings in relation to activities in the securities and futures industry for disseminating to the public or distributing by subscription in Singapore or elsewhere, or with reasonable expectation that they will be so disseminated or distributed.

3.7 We will exclude from the proposed definition the preparation of private credit ratings pursuant to an individual order and which are not intended for public disclosure or distribution by subscription. We will also exclude the activities involved in the operation of internal credit rating systems such as those used by banks for assessing counterparty risks. In our view, these activities need not be subject to the licensing regime as these activities have not given rise to the issues which IOSCO Principle 22 and the regulatory regimes being implemented in other jurisdictions seek to address.

3.8 As it is not the intention to regulate entities engaged in preparing or providing consumer, commercial or industrial credit data (such as through credit bureaus or reference agencies), the definition of "providing credit rating services" excludes the preparation of credit scores, credit scoring systems or similar assessments related to obligations arising from consumer, commercial or industrial relationships.

¹² CRA Code (Revised May 2008) defines "credit rating" as "an opinion regarding the creditworthiness of an entity, a credit commitment, a debt or debt-like security or an issuer of such obligations, expressed using an established and defined ranking system.

¹³ See the definitions of "securities" and "debenture" in section 2(1) of the SFA.

Q1: MAS seeks views on:

- (a) the proposal to regulate CRAs under the existing CMS licensing regime of the SFA; and**
- (b) the proposed definitions of the new regulated activity of “providing credit rating services”, “credit rating” and other related terms as set out in Appendix A to this consultation paper.**

Registration of CRA representatives under the Representative Notification Framework

3.9 When “providing credit rating services” is added as a new regulated activity, CMS licensees for providing credit rating services will be required to appoint and register under the Representative Notification Framework (“**RNF**”) any individual who acts as their representative in respect of the regulated activity or holds himself out as doing so¹⁴. They will need to ensure that their representatives fulfil the fit and proper requirements in accordance with the Guidelines on Fit and Proper Criteria (FSG-G01).

3.10 In general, representatives of CMS licensees and financial advisers have to pass the Capital Markets and Financial Advisory Services (“**CMFAS**”) examinations pertaining to the regulated activity that the representative intends to conduct¹⁵ to be appointed as such. For the representatives providing credit rating services, in view of the higher standards of competence such individuals are generally expected to meet, we propose that the individual must hold at the minimum, a Bachelor’s degree in any discipline. This would be in lieu of passing CMFAS examinations as with the small pool of CRAs currently operating in Singapore, it would not be time or cost-effective to develop CMFAS modules for such representatives. This requirement will be implemented by making an

¹⁴ See section 99B of the Securities and Futures Act.

¹⁵ Notice on Minimum Entry and Examination Requirements of Holders of Capital Markets Services Licence and Exempt Financial Institutions (SFA 04-N09).

appropriate amendment to the Notice on Minimum Entry and Examination Requirements for Representatives of Holders of Capital Markets Services Licence and Exempt Financial Institutions (SFA 04-N09).

Q2: MAS seeks views on:

- (a) the proposal to require CMS licensees for providing credit rating services to appoint and register under the RNF any individual who acts as their representative in respect of the regulated activity of “providing credit rating services” or holds himself out as doing so;**
- (b) the proposal to require such individuals to hold, at the minimum, a Bachelor’s degree in any discipline in order to qualify for appointment and registration as a representative in respect of the regulated activity of “providing credit rating services”; and**
- (c) the proposal not to impose CMFAS examinations on such individuals.**

Prudential requirements

3.11 We propose to require a CMS licensee for providing credit rating services to maintain a minimum base capital of S\$250,000. This will be effected by amending the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations.

3.12 This proposed minimum base capital requirement is the same as that applicable to CMS licensees for advising on corporate finance¹⁶. We believe that the imposition of the same requirement is consistent and appropriate as CMS licensees for providing credit rating services, like CMS licensees for advising on

¹⁶ Paragraph 2(4) of First Schedule to the Securities and Futures (Financial and Margin Requirements for holder of Capital Markets Services Licences) Regulations.

corporate finance, typically do not hold client assets and provide mainly advisory services.

Q3: MAS seeks views on the proposal to impose a minimum base capital requirement of \$250,000.

Exemption from dispute resolution scheme

3.13 Under the MAS (Dispute Resolution Schemes) Regulations 2007, all CMS licensees, except those whose licence relates only to the regulated activity of advising on corporate finance or those who are required by a condition of the licence to only carry on the regulated activity in relation to accredited, expert or institutional investors, are required to be a member of a specified alternative dispute resolution (“**ADR**”) scheme¹⁷.

3.14 Corporate finance advisers are exempted from the requirement as they do not deal with retail investors. As CRAs similarly do not deal directly with retail investors, we propose that CMS licensees for providing credit rating services be similarly exempted from the requirement to join a specified ADR scheme. The exemption can be effected by amending the MAS (Dispute Resolution Schemes) Regulations 2007 to exclude CMS licensees for providing credit rating services from the requirement.

Q4: MAS seeks views on the proposal to exempt CMS licensees for “providing credit rating services” from the requirement to be a member of a specified ADR scheme.

¹⁷ See regulation 4(2) and the First Schedule of the MAS (Dispute Resolution Schemes) Regulations 2007.

4 CODE OF CONDUCT FOR CREDIT RATING AGENCIES

4.1 As with other CMS licensees, CMS licensees for providing credit rating services will be required to comply with existing Regulations, Guidelines and Notices made under the SFA to the extent that they are applicable to all CMS licensees.

4.2 We also propose to prescribe a Code of Conduct for Credit Rating (the “**Code**”) Agencies which apply specifically to CMS licensees for providing credit rating services. The proposed Code is based largely on the IOSCO CRA Code which seeks to:

- Encourage the adoption of procedures and mechanisms promoting the quality and integrity of the rating process;
- Strengthen CRA analytical independence and reduce the possibility that conflicts of interest will interfere with the rating process;
- Provide investors with timely information about a rating and the procedures, methodologies and assumptions behind a rating; and
- Promote procedures and mechanisms to protect non-public information from premature disclosure or by use in ways unrelated to a CRA’s rating.

The draft Code is set out in **Appendix B** to this consultation paper.

4.3 It should be noted that while the Code provides that CMS licensees for providing credit rating services should disclose fully and adhere strictly to their rating methodologies, it does not stipulate the content of the methodologies or that the methodologies used by them should be subject to review or approval by the regulator. This is consistent with the accepted principle that governments and regulators should not interfere with the content of credit ratings or a CRA’s rating methodologies¹⁸.

¹⁸ See Article 23 of the EU Regulation, section 15E(c)(2) of the US Securities Exchange Act of 1934, and Article 325 of Japan’s Cabinet Office Ordinance on Financial Instruments Business, etc.

4.4 We propose to issue the Code pursuant to section 321 of the SFA. The Code is non-statutory in nature. A failure by any person to comply with any requirement in the Code will not of itself render that person liable to criminal proceedings.

4.5 However, a failure by a CMS licensee for providing credit rating services to comply with the Code will be taken into account by the Authority in determining whether the licensee satisfies the requirement that it is fit and proper to remain licensed and whether to revoke or suspend its licence under section 95 of the SFA.

4.6 Similarly, a failure by a representative of a CMS licensee for providing credit rating services to comply with the Code will be taken into account by the Authority in determining whether the representative satisfies the requirement that he is fit and proper to remain as an appointed, provisional or temporary representative and whether to revoke or suspend the status of the representative as an appointed, provision or temporary representative under section 99M of the SFA or whether to impose any conditions or restrictions on the representative under section 99N of the SFA.

Q5: MAS seeks views on the proposed Code of Conduct set out in Appendix B to this consultation paper.

5 TRANSITIONAL PROVISION

5.1 To allow CRAs already operating in Singapore sufficient time to apply for the requisite CMS licence and comply with all applicable regulatory requirements, we intend to provide a transition period of 6 months during which these CRAs may operate without holding a CMS licence in respect of the regulated activity of “providing credit rating services”. The transition period of 6 months is to commence from the date on which the legislative and regulatory changes implementing the new regulated activity of “providing credit rating services” take effect.

Q6: MAS seeks views on the sufficiency of the proposed transition period.



Monetary Authority of Singapore