
Credit Rating Agencies (“CRAs”)¹

Is a staff member, who performs marketing or business development functions for a CRA, required to be licensed for Type 10 regulated activity (providing credit rating services)?

Posted on 21.04.2011

18.1 No. Only a staff member, who prepares credit ratings for a CRA, is required to be licensed. Marketing or business development activities are unlikely to be regarded as “providing credit rating services”. Accordingly, individuals who solely perform these activities are unlikely to be required to hold a Type 10 licence.

If a firm only prepares credit ratings for its internal use, or shares or analyzes commercial or consumer credit data, will this activity trigger any licensing requirement in relation to Type 10 regulated activity?

Posted on 21.04.2011

18.2 No. If a firm prepares credit ratings only for its internal use, such as a bank’s internal systems for assessing counterparty risks, it is unlikely that the firm will be regarded as “providing credit rating services” for the purposes of the Securities and Futures Ordinance (“SFO”) because the credit ratings would neither be intended for dissemination to the public or distribution by subscriptions, whether in Hong Kong or elsewhere, nor reasonably expected to be so disseminated or distributed.

Similarly, a firm (such as a commercial credit reference agency) is unlikely to be required to be licensed for Type 10 regulated activity if it only gathers, collates, disseminates or distributes

¹ For the purposes of this FAQ, the term “CRA” means a firm licensed or registered under the SFO to carry on business in Type 10 regulated activity (providing credit rating services).

information concerning the indebtedness or credit history of any entity other than an individual. Consumer credit reference agencies are also excluded from the regulatory regime because the definition of “credit ratings” under the SFO excludes opinions regarding the creditworthiness of individuals.

Would preparation of “private ratings” constitute “providing credit rating services”?

What if a CRA subsequently intends to disseminate those “private ratings” to the public or distribute by subscription?

Posted on 21.04.2011

18.3 “Private ratings” refer to credit ratings prepared pursuant to a request made by a person which are exclusively prepared for, and provided to, the person and that are neither intended for dissemination to the public or distribution by subscription, whether in Hong Kong or elsewhere, nor reasonably expected to be so disseminated or distributed. Therefore, preparation of such private ratings would not constitute “providing credit rating services”. Where a CRA provides private ratings, it is required, by prior written agreement entered into between it and the rated entity, to prohibit the rated entity from disseminating such ratings, or permitting the rated entity’s dissemination, to the public.

However, if the CRA subsequently wishes to publicly disseminate or distribute by subscription a “private rating” prepared by it, it is required to first ensure that the rating has been prepared in compliance with provisions of the Code of Conduct for Persons Providing Credit Rating Services (“CRA Code”) before such dissemination or distribution.

Is Type 4 regulated activity (advising on securities) distinct from Type 10 regulated activity?

Where a Type 4 licensee comments on the creditworthiness of a financial instrument during the course of advising a client concerning the acquisition or disposal of securities, would he be required to hold a Type 10 licence as well?

Posted on 21.04.2011

18.4 There is no overlap between Type 4 regulated activity and Type 10 regulated activity. The former involves the giving of advice to a client concerning the acquisition or disposal of particular securities by that client. Type 10 regulated activity is different and involves the provision of opinions, expressed using a defined ranking system, regarding the creditworthiness of a corporate body or an instrument of the types stipulated in the definition of “credit ratings” under the SFO. Credit ratings do not constitute advice to a client concerning the acquisition or disposal of securities by that client. The expression of an opinion as to creditworthiness clearly involves an expression of opinion (not advice) as to whether credit, which might be extended to the corporate body or on the security of the instrument that is rated, is likely to be realised.

Because a Type 4 licensee’s comments concerning the creditworthiness of the financial instrument would be unlikely to be expressed “using a defined ranking system”, and that his reference to the creditworthiness of a particular financial instrument would merely be incidental to his business of advising on securities, it is very unlikely that a Type 4 licensee would be required to hold a Type 10 licence.

Is a staff member of a licensed CRA required to be licensed for Type 10 regulated activity for his assisting the rating analysts in collecting and preparing credit history or indebtedness of a corporate body?

Posted on 21.04.2011

18.5 If the staff member is only collecting and preparing credit data for the rating analysts without performing any analysis, he is unlikely to be regarded as performing a regulated function in relation to “providing credit rating services”.

If an overseas-based rating analyst participates in a rating committee meeting via telephone conference or video conference with the licensed CRA, is he required to be licensed for Type 10 regulated activity?

Posted on 21.04.2011

18.6 No. Because of his absence from Hong Kong, the rating analyst is unlikely to trigger a licensing obligation.

Can a CRA provide ancillary services? Would the consultancy services offered by a CRA to the rated entity be regarded as ancillary services?

Posted on 21.04.2011

18.7 In general, a CRA should not carry on any business which can reasonably be considered to have the potential to give rise to any conflict of interest in relation to its business of providing credit rating services. If the CRA intends to provide ancillary services, it should ensure its compliance with paragraph 30 of the CRA Code. In any event, a CRA is not allowed to provide the consultancy or advisory services to a related entity, or its related party, regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related party.

Is a person required to be licensed if he prepares credit ratings of sukuk?

Posted on 21.04.2011

18.8 Sukuk, sometimes known as Islamic bonds, are Shariah-compliant financial instruments. Essentially, a Type 10 licensing obligation may be triggered if the financial instrument being rated constitutes an agreement to provide credit or if it acknowledges, evidences or creates indebtedness. This will be a question of fact. If the instrument conveys an obligation to pay a pre-determined amount of money, it would create “indebtedness” within its ordinary meaning and may therefore fall within the definition of “debt securities”. Thus, a person preparing credit ratings of such instruments might well be regarded as “providing credit rating services” and might well be required to be licensed.

Can a CRA with a small operation in Hong Kong outsource its back office functions, such as compliance, accounting, human resources or IT functions to its group companies or external professional or consulting firms?

Posted on 21.04.2011

18.9 A CRA with a small operation in Hong Kong may outsource those back office functions to its group companies or external professional or consulting firms. However, as in the case of other existing licensed corporations, the CRA and its senior management would remain fully and ultimately responsible for the performance of the compliance function and the outsourced activities.

What kind of experience would be considered as relevant industry experience of an individual applicant in relation to “providing credit rating services”?

Posted on 21.04.2011

18.10 This will be a question of fact. In general, apart from being an analyst involved in the rating process of a CRA, experience acquired by an individual in relation to credit risk management of financial institutions, financial analysis, credit analysis or bank’s internal counterparty risk assessment would also be considered as relevant to “providing credit rating services”.