Business Information Industry Association
Asia Pacific – Middle East Limited

BIIA

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The Licensing Department
Securities and Futures Commission
8/F Chater House
8 Connaught Road Central
Hong Kong

Ref.: Consultation Paper Concerning the Regulatory - Oversight of Credit Rating Agencies

Introduction

The Business and Information Industry Association (BIIA) welcomes the opportunity to contribute to the Securities and Futures Commission's (SFC) Consultation Paper Concerning Regulatory Oversight of Credit Rating Agencies (Consultation Paper). BIIA represents the interests of members who provide business information services in general, credit information and credit rating services in particular. BIIA is based in Hong Kong however the membership spans the globe.

With regard to the nature and purpose of ratings BIIA would like to stress the fact that the term 'credit rating' is still widely used by credit grantors and by the credit information industry. For example 'borrower rating' or 'trade credit rating services' are used in the evaluation of the creditworthiness of individuals and businesses. Such services are outside the scope of capital market transactions and therefore should not be part of the proposed regulations. BIIA is aware that one of its members, Dun & Bradstreet Hong Kong has submitted its comments and suggestions in this regard and BIIA shares the views expressed by Dun & Bradstreet.

As a general matter, BIIA applauds SFC's desire to establish a regulatory regime that is consistent with developing international standards. Such an approach ensures a regulatory regime that will foster increased transparency about the ratings process, foster greater understanding among investors as to the nature and purpose of ratings, and encourage continued competition and innovation among credit rating agencies.

As the Consultation Paper notes, such an international approach to regulation already exists in the form of the May 2008, International Organization of Securities Commissions (IOSCO) revised Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Code). BIIA believes that many of the proposed regulations from FSC are consistent with the agreement by the G20 nations that the IOSCO Code should be the regulatory oversight regime for nations to employ for ratings required for regulatory purposes. As noted in the Consultation Paper, enforcement of credit rating agency (CRA) compliance with the IOSCO Code should be undertaken by national authorities.

However, it is BIIA's view that in some instances, FSC's recommended regulatory approaches are not consistent with the spirit or letter of the IOSCO Code and may lead to lessened competition among CRAs in Hong Kong, perceptions among investors that FSC requirements will be perceived as granting a government "endorsement" or a particular CRA or a particular rating, and lead to a diminution of the number of ratings issued on debt instruments originating in Hong Kong or of interest to Hong Kong investors.

Specific Comments

Although BIIA will not respond to each question posed in the Consultation Paper, we do offer the following comments in regard to specific issues raised:

Appropriateness of Adopting Regulations under the Current FSC Licensing Regime While Maintaining International Consistency

BIIA believes that adopting regulations under the current FSC licensing regime is generally appropriate, but would emphasize again the necessity of developing regulations that are consistent with the IOSCO Code. We note, for instance, that the FSC proposes creation of an individual licensing regime for credit rating analysts. Such regulation goes beyond the IOSCO Code and will most certainly have a chilling effect on the issuance of ratings. It should be noted that CRAs generally operate on a global basis, with analysts for certain types of securities and bonds sometimes physically located outside the home territory where the security or bond originates. Requiring licensing of analysts may extend the reach of Hong Kong regulatory authorities far beyond Hong Kong and result in conflicts among national authorities regarding accountability for ratings issued on a global basis. In addition, saddling individual analysts with registration requirements and individual oversight by FSC may have the unintended consequence of making it more difficult for CRAs to attract highly qualified analysts.

A more appropriate reach of the licensing/registration of CRAs under the FSC proposals would be to encourage more transparency around the processes and procedures that CRAs have in place, including internal compliance regimes. Such an approach properly places responsibility for ratings and adherence to regulatory requirements with the licensed entity, not with any particular individual analyst who may be involved in analyzing debt. BIIA notes SFC's stated objectives for regulating CRAs indicates that one primary purpose is to "ensure that the credit ratings it prepares are assigned by the licensed corporation or registered institution (or its affiliated corporation) and not by any individual representative. (Paragraph 8 of the Consultation Paper). Requiring individual licensing seems at odds with this laudable approach.

In addition, BIIA believes that training and assessment of analysts' skills properly lies with CRAs and should not be the subject to regulation by FSC. BIIA would recommend that FSC abandon this proposal, particularly to avoid any appearance of government interference with or endorsement of any particular training program or qualifications for employment that could lead investors to believe that FSC stands behind the quality of the CRA and its ratings. Another, more workable approach that ensures that CRAs institute and maintain active, professional training programs in accordance with the licensed CRAs scope of business, code of conduct and internal requirements, with adequate disclosure to FSC about its programs. This method of oversight, combined with the requirement for CRAs to have responsible officers (paragraph 30 of the Consultation Paper), will both preserve adequate independence of CRAs from government interference while maintaining the overall, regulatory objectives outlined in the Consultation Paper.

Effectively Distinguishing "Providing Credit Rating Services" from "Advising on Securities"

BIIA appreciates SFC's proposal to distinguish effectively between "providing credit rating services: from "advising on securities" and generally supports efforts by regulators to identify and enforce adequate oversight and accountability to avoid potential conflicts of interest involving the rating process. However, the proposed remedies discussed in the Consultation Paper go much further than is necessary to ensure that CRAs institute and maintain separation between rating and advisory services and may have the unintended consequence of stifling further competition in the ratings industry to serve Hong Kong investors . As drafted, the prohibition would also deny those who issue bonds and securities from access to otherwise valuable service offerings by CRAs and their affiliated entities.

As noted in Paragraph 16 of the Consultation Paper, SFC's approach in its proposal is to distinguish issuing credit ratings from Type 4 regulated activities and to clarify that credit ratings fall outside the definition of "advising on securities". BIIA believes that the draft amendments effectively distinguish these two activities, consistent with the global standards for regulation of CRAs in the IOSCO Code. Credit ratings are not recommendations for investors in regard to the suitability of a particular bond or security for an individual investor, nor a recommendation to buy, sell or retain any particular bond or security.

Currently, many CRAs, including those subject to registration requirements in the European Union and the United States, offer advisory services unrelated to obtaining a particular rating. Such services may include advisory services on business operations, market trends, and the general nature of the securities and bond markets. These service offerings are helpful to a better understanding of issuers of debt (particularly small and medium enterprises or emerging market participants) of how best to meet their financing needs through offerings in the public markets. They do not entail conflicts of interest in regard to rating a particular debt instrument, as long as the CRA makes transparent, and enforces, a "firewall policy" to ensure that the credit rating and surveillance processes are not compromised as a result of other advisory services unrelated to obtaining a particular rating opinion from the CRA The key approach then is not to preclude the offering of advisory services *per se*, but to establish regulations that foster transparency regarding management of potential conflicts of interest for CRAs and make certain that the policies established by the CRA are strictly enforced through accountability to the regulator.

This approach would be consistent with regimes established in other jurisdictions, namely through the Australian Securities and Investments Commission license conditions requiring CRAs to comply with the IOSCO Code on a mandatory basis from 1 July 2010 the U.S. Securities and Exchange Commission ("SEC"). SEC rules in particular permit credit rating agencies that are separately identifiable business units to register as regulated entities without threat of bringing other, affiliated business under regulation and mandate extensive disclosure requirements regarding management of conflicts of interest.

Finally, BIIA would note that recently at least two multinational corporations have either instituted new credit rating services or intend to do so in the near future (See: http://www.morningstar.com/credit-rating/corporate.aspx and http://www.nytimes.com/2009/08/29/business/29kroll.html). Both these organizations, and likely others in the future, currently offer a number of lucrative, consulting or advisory services. The proposed SFC requirement that these and other companies offering credit ratings must "separate, *operationally and legally*, its credit rating business and representatives who are involved in the rating process from any other businesses of the licensed or registered person, including consulting businesses, which may present a conflict of interest" will undoubtedly prove to be a barrier to entry into the Hong Kong ratings industry (emphasis added). This overly proscriptive requirement may therefore have the unintended consequence of denying Hong Kong investors from a more diverse and competitive group of CRAs from which to seek information regarding the creditworthiness of any particular debt instrument or issuer.

Conclusion

BIIA believes that the majority of proposed FSC rules to institute a new regulatory regime are reasonable and workable. We also strongly support FSC's efforts to set rules that are internationally consistent and focused on greater transparency about the ratings process, as well as the purpose and nature of ratings. Without such consistency, Hong Kong investors may find themselves with fewer ratings opinions from which to acquire information regarding the creditworthiness of any particular bond, security or issuer of debt. Equally important and consistent with international standards is the need to avoid overly proscriptive requirements that interfere with the ratings process and internal operational activities in a manner that may leave Hong Kong investors with the impression that the FSC is endorsing any particular CRA or its ratings.

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As the FSC continues with development of the proposals discussed in the Consultation Paper, BIIA would be pleased to offer further comments and work to achieve regulations that are internationally consistent and foster transparency and competition in the ratings industry and avoid hampering innovation and competition in the ratings industry that can only benefit Hong Kong investors

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