coface GREATER CHINA Services

18 August 2010

Securities and Futures Commission
8th Floor Chater House
8 Connaught Road Central
Hong Kong

By Email & Post

Re: Comments on Consultation Paper concerning the Regulatory Oversight of Credit Rating Agencies

Thank you for sharing with Coface about the Consultation Paper concerning the Regulatory Oversight of Credit Rating Agencies dated 19 July 2010. It denoted a step forward for Hong Kong to set up a regulatory framework for Credit Rating Agencies (CRA), in order for the credit rating activities in Hong Kong and their regulations to be at the best international standard.

We fully support the bringing in of oversight regulations of credit ratings and it will be our intention to apply under the new regulations as an existing CRA as soon as practical after their implementation.

We are pleased to submit our response to the List of Questions under Appendix D in the Consultation Paper, please refer to our comments listed in Appendix enclosed with the letter.

We look forward to working with the SFC to ensure Hong Kong plays a prominent role in the development of a sound credit ratings regulatory environment in Asia to encourage competition, independence and credibility in this vitally important area.

If you have any questions to our comments, we are welcome to have further discussion with SFC.

Encl. Appendix - Comments on Consultation Paper concerning the Regulatory Oversight of Credit Rating Agencies

Appendix –
Comments on Consultation Paper concerning the Regulatory Oversight of Credit Rating Agencies

Q1 Is it appropriate for Hong Kong to subject CRAs to a regulatory oversight regime consistent with international developments?

It is definitely appropriate for Hong Kong to have a regulatory oversight regime consistent with international developments. Coface believes that enhanced regulation would help assure the recognition of rating activity up to international standard, also open up the market for ratings to more competition and to ensure that conflicts of interest and other deficiencies inherent in the current business models are minimized.

Q2 Should regulatory oversight of CRAs be achieved by extending the existing licensing regime under the SFO to CRAs and those of their staff who perform regulated functions?

This approach is logical and consistent since SFC has been in the role of regulating related activities in financial markets in Hong Kong for years. SFC has sufficient experience and the framework to extend the existing licensing regime further; and it is likely to create a minimum of need for substantial modifications to the current SFC Ordinance.

However as regards to licensing individuals (rating analysts), we would propose not being too proscriptive on the requirements, to avoid too many staff in the rating agency falling under the net. We suggest the need for licensing individuals should be kept to a strict minimum and grandfathering should be flexibly adopted.

Q3 Do our draft amendments to the SFO effectively distinguish "providing credit rating services" from "advising on securities"?

The draft amendments distinguished the difference between "providing credit rating services" from "advising on securities" in a quite clear way, for it is crucial to get these 2 types distinguished and also avoid potential conflicts of interests in between.

Q4 Should the proposed new licensing requirement apply to the rating of sukuk?

For sukuk, these may include some structured instruments creating indebtedness and involving creditworthiness, so it would be good if the proposed new licensing requirements also apply to the rating of sukuk.

Q5 Should the following activities be excluded from the proposed new licensing requirement:
(a) preparing credit ratings for an organization's internal purposes;
(b) preparing private credit ratings; and
(c) sharing or analyzing consumer or commercial credit data (such as through consumer or commercial credit reference agencies)?

For abovementioned activities, they are for internal use or private purpose, and for (c) it only involves credit data or information provision through agencies, it may be regarded as out of the scope of credit rating activities and excluded form the proposed new licensing requirement.

caringcompany
Coface Greater China Services Limited : 8th Floor, Sunning Plaza, 10 Hysan Avenue, Causeway Bay, Hong Kong
科法斯大中華信用管理有限公司：香港銅鑼灣希慎道10號新寧大廈8樓
Tel (852) 2368 6965 - Fax (852) 2367 7275 - Website : www.coface.com.hk - E-mail : coface@coface.com.hk
A direct subsidiary of Coface SA
@rating SGS

Q6 Further to question 5, do our draft amendments to the SFO effectively exclude these activities from the proposed new licensing requirement?

Further to above, the draft amendments to the SFO states in both Primary Regulation and Appendix that those activities are excluded from the scope, which we believe it is sufficiently and clearly stated.

Q7 Are the proposed paid-up share capital and liquid capital requirements for Type 10 regulated activity appropriate?

Credit rating activities is neither bearing assets of clients nor rated target it may not need to have very stringent capital requirement, the regulatory capital should be a minimum. The proposed paid up share capital and liquid capital requirements are appropriate. For the control of such activities is more on integrity and conflicts of interests, which could be achieved through the proposed licensing requirement.

Q8 Does the CRA Code of Conduct satisfactorily set out the factors that should guide CRAs in the conduct of their business and which should be relied upon by the SFC in considering whether a person is, or remains, fit and proper to be licensed or registered or Type 10 regulated activity?

The CRA Code of Conduct is close to the international standard IOSCO. Coface has filed for official accreditation in Europe with CESR at the same time, which is also referring the Code of Conduct similar to the IOSCO standard. Coface believes it sufficiently sets out factors to guide a CRA as well as individual persons in this industry about the way of conducting business.

Q9 Should persons licensed or registered for Type 10 regulated activity be permitted to be licensed or registered for other types of regulated activity?

Our view is that persons engaged in rating should not engage in any other activity which may bring in actual or potential conflict of interest. A rating company should probably not be involved in the sale or promotion of securities issued by a company it has rated. At least we suggest Type 10 regulated activity (providing rating credit rating services) should not be permitted to be licensed or registered for Type 4 regulated activity (advising on securities).

Q10 Should persons licensed or registered for Type 10 regulated activity be subject to a sole business restriction?

It may not necessary to restrict to a sole business restriction provided that the scope of other activities that the CRA engaged in at the same time do not materially introduce any conflict of interest.

Q11 Is the draft list of Recognized Industry Qualifications and Local Regulatory Framework Papers for Type 10 regulated activity appropriate?

The draft list of Recognized Industry Qualifications and Local Regulatory Framework Papers for Type 10 regulated activity is quite close to normal requirements of other regulated activities e.g. Type 4, it is very complete to assure the competence of individual persons engaged into related activities. However in our view, this system would create a difference with other regulations (Europe in particular), and there are

caringcompany
Coface Greater China Services Limited : 8th Floor, Sunning Plaza, 10 Hysan Avenue, Causeway Bay, Hong Kong
科法斯大中華信用管理有限公司：香港銅鑼灣希慎道10號新寧大廈8樓
Tel (852) 2368 6965 – Fax (852) 2367 7275 – Website : www.coface.com.hk – E-mail : coface@coface.com.hk
@rating
A direct subsidiary of Coface SA

so important differences among different rating types that the expertise needed to cover all types may be very complex and could justify to look at expertise and training specific to each type of rating, combined with a general culture of business and economy through the degree the person holds.

And it may be too stringent considering that providing credit rating activities does not involve providing advice or bearing any assets of client. The proposals include the possibility of grandfathering rating analysts working for existing CRAs which we support, however we would also suggest that staff recruited by such CRAs (with say a minimum five years operations) with appropriate level of education (degree in finance, economics, mathematics) would be exempted from the technical papers, provided CRAs internal training programs are subject to validation. CRAs could undertake to run regular (at least once a year) trainings, courses by appropriate providers on regulatory issues.

Q12 Are the proposed transitional arrangements appropriate?

Taking into account of comments in Q11, the proposed transitional arrangement seems logical and appropriate. It may be better to have clearer indication on the duration of the transitional period.

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Coface Greater China Services Limited · 8th Floor, Sunning Plaza, 10 Hysan Avenue, Causeway Bay, Hong Kong
科法斯大中華信用管理有限公司：香港銅鑼灣希慎道10號新寧大廈8樓
Tel (852) 2368 6965 - Fax (852) 2367 7275 · Website : www.coface.com.hk · E-mail : coface@coface.com.hk
A direct subsidiary of Coface SA
@rating SGS