



Australasian
Compliance
Institute

Licensing Department
Securities and Futures Commission
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Hong Kong

Via email: creditratingsagencies@sfc.hk

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Submission on Regulation of Credit Ratings Agencies

The Australasian Compliance Institute (ACI) would like to take the opportunity to thank the Securities and Futures Commission for providing an opportunity for ACI to make a submission on the proposed regulation of Hong Kong's credit rating agencies.

ACI is the peak industry body for the practice of compliance in Australasia. Our members are compliance, risk and governance professionals actively engaged in the private, professional services and Government sectors within Hong Kong, Australia, New Zealand, Singapore and Indonesia.

This submission will only address those issues in the consultation paper that ACI believes will have a direct impact upon its members. Having said this, by way of general comment, there does not appear to be a distinction drawn between the credit ratings advice that is provided for the purpose of decision making by wholesale, business or sophisticated investors versus the ratings that will find their way into products acquired by retail investors. ACI believes that it is safe to assume that the level of knowledge in investment products that is possessed by retail clients is less than that of the other types of investors listed above and therefore a greater reliance will be placed upon these ratings by retail investors. Therefore ACI believes that there should be a higher standard or care placed upon ratings advice given by ratings firms when their decisions will be used by retail investors versus wholesale or sophisticated investors.

In addition, the requirements outlined in the consultation paper will add to the overall compliance responsibilities faced by organisations that offer credit rating services. Therefore ACI would suggest that there is a need to ensure that there is a strong community of compliance professionals that can be drawn upon to ensure that these and other regulatory obligations can be adhered to by effected organisations. ACI would recommend consideration be given to the recognition of compliance qualifications as part of the SFC's current review of Recognised Industry Qualifications.

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We now turn our attention to some of the specific questions asked by the SFC in its consultation paper.

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

ACI supports this proposition within the context of ensuring regulatory consistency of credit rating agencies around the region.

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?

ACI supports use of the existing regulatory regime to capture credit rating agencies. In doing so, the SFC would be removing the necessity of creating additional legislation and adding to the overall regulatory burden faced by the financial services industry.

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

We believe that the proposed regulation of credit ratings agencies does not make a significant enough distinction between the provision of credit ratings services and investments advice; as outlined in our general comments above.

While ACI appreciates the distinctions made between credit ratings services and securities advice as outlined in paragraphs 16 and 17 of the consultation paper, the proposal as it currently stands ignores the nexus between the credit rating that is assigned to a financial product, institution or organisation and the ultimate decision that is made by the investor. The credit rating provided is used by many as an indication of the possibility of default and therefore a measure of how risky the investment in that product or organisation is likely to be. This then influences the decision to proceed with the investment and if it does, what the expected rate of return should be to offset the risk that has been accepted by the investor.

A number of the complex financial products that emerged prior to the GFC were sold to investors, particular retail investors, on the basis of their credit rating alone. Consequently the credit ratings placed upon these products contain an implied level of financial advice. That is why in Australia, ASIC insisted that credit ratings agencies that were going to be rating products that would be taken up by retail investors needed to have an Australian Financial Services Licence (AFSL) that has a retail authorisation in addition to their wholesale authorisation.

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 for Type 10 regulated activity?

ACI believes that the code of conduct will achieve the objectives of guiding the credit rating agencies in terms of the conduct they are expected to exhibit when producing credit ratings. We do however question if the Code of Conduct would be better issued as a Regulatory Guidance note? ACI is unsure what legal standing or enforceability the Code of Conduct will have. It is our belief that if the Code of Conduct cannot be enforced then irrespective of its content, it will not achieve its regulatory objective. It is on this basis that we suggest an alternate regulatory vehicle, however if we have overlooked the legislative stature of the proposed Code of Conduct then we withdraw these observations.



Are the proposed transitional arrangements appropriate?

We believe the SFC has allowed a sufficient timeframe for the establishment of the proposed new oversight arrangements of credit rating agencies. Having said this, we believe that the SFC needs to take into consideration the significant amount of regulatory change that is currently taking place within Hong Kong and the rest of the region. This is especially true once the SFC embarks upon its enforcement program in respect to this program in the first instance.

Compliance bottle necks may arise due to tight resourcing, which may mean that some organisations have not fully finalised their compliance programs or do not have their programs established in a manner that meets the SFCs specifications. Under these circumstances the SFC needs to take into consideration a failure to comply due to complete inaction versus a compliance failure where evidence of substantial progress towards a complete compliance program can be identified.

Once again ACI would like to thank the Securities and Futures Commission for providing an opportunity for ACI to make a submission on its proposed regulation of credit ratings agencies. Should you require any additional information or seek clarification on the comments that appear in this submission please do not hesitate to contact ACI on +612 9290 1788.