

Credit Rating Services Bill, 2012

Response by National Treasury to comments received

Presenter: Ismail Momoniat and Roy Havemann | National Treasury | 8 August 2012



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Structure

1. Background
2. Key issues
 - Scope and application (s 3 and 4)
 - Plain language (s 1(5)b)
 - Liability (s 19)
 - Endorsement (s 18)
 - Offences (s 32)
3. Other issues

1. Background

- National Treasury considered all comments from various stakeholders made during the hearings held on 22 May 2012
- Focus of today:
 - Summary presentation of National Treasury response
 - Detailed response document
 - Proposed changes to Bill

2. Scope and application

- **Number of concerns expressed:**
 - Bill too strict on ratings agencies:
 - Complexity of regulating multinational agencies
 - Regulating “opinion” or “free speech”
 - Small number of analysts in South Africa
 - Using Johannesburg as base to expand into Africa
 - Potential for agencies to exit South Africa if regulation too onerous
 - Bill too lenient:
 - Exemption provisions too lenient
 - Need to allow for removal of agencies
 - Stronger liability provisions
 - Stronger provisions on key personnel

South Africa will remain at forefront of regulation, but not first mover

- South Africa will be the first country in Africa to meet the equivalence requirements
- That said, National Treasury aware of:
 - Global nature of credit ratings, and ratings agencies;
 - New developments in ratings regulation globally;
 - The complexities of imposing regulation on foreign entities; and
 - Policy objective of creating a financial services hub for Africa

In response return to rationale for introducing Bill

- **Investor protection:**
 - South African investors need to be certain that ratings they are using are undertaken in an appropriate way
- **Protection from unscrupulous agencies**
 - No framework for what is a good agency – e.g. municipal bonds
- **EU imposes strict equivalence requirements**
 - Essentially, CRAs must operate in a jurisdiction with an equivalent or higher standard of regulation by no later than 30 April 2012
 - Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore and the United States meet these requirements
 - South Africa should meet these requirements with this Bill

More philosophical questions

- **Regulation of an opinion?**
 - Agencies only express an opinion based on data at their disposal
 - Cannot be held responsible for how investors use such an opinion
 - An opinion is free speech and cannot be regulated
- **General approach is that the opinion itself is not regulated**
 - Process at how that opinion is derived
 - Methodology used should be reasonable
 - *Bona fide* intentions
 - Conflicts of interest etc.
- United States has established that Dodd-Frank is not an infringement of free speech

Offences

- Current draft of the Bill inadvertently criminalises relatively minor transgressions
- Proposed to narrow this to section 3(2) – if you pretend to be a credit rating agency but you are not, it is a criminal offence

3. Plain language – section 1(5)(b)

- A number of concerns about “onerous” plain language requirement.
- For the purposes of the Act plain language is defined as “ a credit rating, policy, code, document or information is in plain language if it is reasonable to conclude that **a person of the class of persons for whom the credit rating, policy, code, document or information is intended**, with average literacy skills and experience in dealing with credit ratings, credit rating services and credit rating agencies, could be expected to understand the content, significance and import of the credit rating, information, policy, code, document or information without difficulty...”

4. Liability – section 19

- A number of comments raised:
 - Concern expressed that liability provisions could threaten viability of CRAs
 - Liability regime is potentially higher than already existing provisions
 - Reliance on third-party data

See Response document p32

- **Note:** criminal liability has now been taken out

In response, National Treasury considered liability provisions

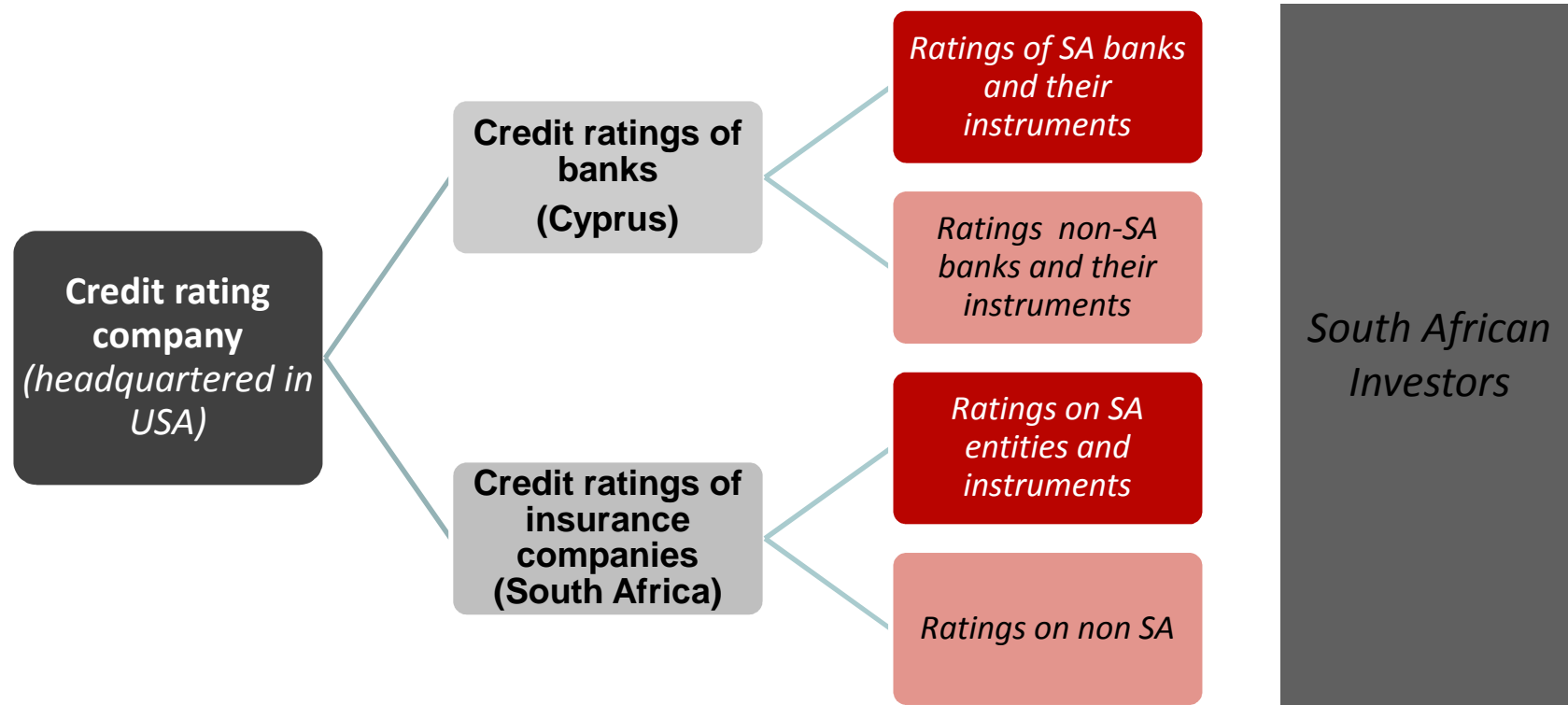
- External advice:
 - University of Witwatersrand commercial law department
 - Received formal legal opinion from Bowman Gilfillan
- Reviewed international liability provisions
 - European Union: *proposed civil liability regime*
 - United States: *CRA no longer exempt*
 - Other
- Considered opinion that current liability provisions codify common law
 - Substantial case law and interpretation of common law liability
 - Courts will rely on principles and precedent rather than statute
 - Ensure that agencies cannot contract out of liability
- Do not propose changes to s 19

Endorsement of ratings and role of foreign credit ratings agencies in South Africa

- Substantial number of comments on the proposed endorsement regime
- May prove to be a disincentive for agencies to operate in South Africa
 - Read together with section 19 creates liability for SA credit ratings agencies
 - Liability is with regards to ratings on non-South African instruments or entities
- Comments (see p 28):
 - “Double regulation”
 - Substantial additional regulatory burden
 - Burden for regulator

Credit rating agencies operate globally...

- The three main agencies in South Africa operate as true multinationals, with different services provided in different jurisdictions



... Bill expressly allows for multinational ratings agencies to operate in South Africa

- **Section 3(2)** With effect from a date determined by the Minister by notice in the *Gazette*, a person may not perform credit rating services or issue a credit rating that is published in the Republic, unless that person is registered as a credit rating agency in terms of section 5 of this Act.

“registered credit rating agency” means a credit rating agency registered in terms of section 5 of this Act;

- **Section 5(1)** An application for registration as a credit rating agency must be made in the form and manner prescribed by the registrar, and must be lodged with the registrar and be accompanied by—
- (a) a certificate of incorporation of the applicant, where the applicant is located in the Republic, or proof of registration of the applicant as an external company under the Companies Act, where the applicant is an external credit rating agency;

- **"external credit rating agency"** means a person who provides credit rating services and who is authorised or registered by a regulatory authority to perform credit rating services similar to those regulated under this Act and who is subject to the laws of a country other than the Republic, which laws—
 - (a) establish a regulatory framework which is approved by the registrar as being equivalent to that established by this Act; and
 - (b) are supervised and monitored by a regulatory authority;

And there are outsourcing provisions

- Indeed, the provision in section 12(1) already gives a South African registered rating agency the ability to outsource functions to an entity in the same group
- 12.(1)** A credit rating agency may not, without the prior written approval of the registrar, outsource any of its operational functions, save for outsourcing to an entity in the same group as the credit rating agency.
- National Treasury's view is that the Bill is sufficiently flexible
 - Only area of contention is endorsement and use for regulatory purposes

As a backstop, there are relatively broad exemption powers

Exemption powers

27. (1) The registrar may exempt any credit rating agency or external credit ratings agency from, or in respect of, any provision of the Act if the registrar is satisfied that –

(a) practicalities impede the strict application of a specific provision of the Act; and

(b) the granting of the exemption will not –

(i) conflict with the public interest;

(ii) prejudice the interests of -

(aa) the clients of credit rating agencies;

(bb) the users of credit ratings or credit rating services;

or (cc) regulatory authorities that rely on, refer to, or use credit ratings in their supervision and regulation activities; and

(iii)

frustrate the achievement of the objects of this Act.

Endorsement and proposed change to Section 5

- The intention of the endorsement provision is to strike a balance between allowing the use for regulatory purposes of ratings that are produced / issued outside of the Republic, and ensuring that the Registrar is able to exercise appropriate oversight over the ratings that are used for such purposes.
- The effect of the proposed change to section 5 of the Bill is that an external credit rating agency could register as a credit rating agency in the Republic, if it registers as an external company in terms of section 23 of the Companies Act.
- If the external credit rating agency does so, then it would effectively be treated as a local credit rating agency for the purposes of the Act.

Endorsement and proposed change to Section 5 (contd.)

- This change would give the Registrar oversight over credit rating agencies that operate in the Republic as branch offices (and hence would enable the use of ratings issued by that company for regulatory purposes, regardless of where they are issued).
- However, the concept of endorsement has been retained for CRAs that operate within South Africa as independent subsidiaries and who wish to have the ratings issued by other companies within the same group eligible for use for regulatory purposes – these agencies may apply for exemption if they meet G-20 requirements.

Note:

- G-20 commitment to reduce reliance on credit ratings
- Limited number of instances where ratings are used for regulatory purposes

Other

- Other comments
 - Detailed response document
 - Attached matrix provides responses to every comment made during Parliamentary process
- Also provided to Standing Committee:
 - Comments and responses on preliminary draft of Bill
 - Opinion by Bowman Gillfillan on liability provisions
 - EU regulations

Thank you