



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 117

# Consent to quote credit ratings in disclosure documents and PDSs

September 2009

## About this paper

We are considering whether to withdraw class order relief that allows issuers to cite credit ratings in disclosure documents and Product Disclosure Statements (PDSs) without the consent of credit rating agencies.

We are seeking comment on this relief, particularly from issuers and their advisers, credit rating agencies and organisations representing retail investors.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This paper was issued on 10 September 2009 and is based on the Corporations Act as at 10 September 2009.

### Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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## The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on consent to quote credit ratings. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Business Cost Calculator report and/or a Regulation Impact Statement: see Section C, 'Regulatory and financial impact'.

### Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 22 October 2009 to:

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 Australian Securities and Investments Commission  
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### What will happen next?

<b>Stage 1</b>	10 September 2009	ASIC consultation paper released
<b>Stage 2</b>	22 October 2009	Comments due on the consultation paper
<b>Stage 3</b>	November 2009	Announcement of decision on proposal to revoke current consent to quote relief

## A Background to proposal

### Key points

The *Corporations Act 2001* requires an issuer to obtain the consent of a person to cite a statement made by them in a disclosure document or PDS.

The person who made the statement must consent to inclusion of the statement in the context in which it appears in each disclosure document or PDS.

We have given class order relief so that issuers do not need the consent of credit rating agencies to cite a credit rating in a disclosure document or PDS.

Credit rating agencies will need to obtain an Australian financial services (AFS) licence by 1 January 2010. Issuers planning to cite a credit rating in a disclosure document or PDS, or in advertising, will need to check whether the credit rating agency is licensed and whether they have a retail or wholesale licence authorisation.

### Consent to quote requirement

- 1 An issuer must not cite a statement made by a person in a disclosure document or PDS unless the person has consented to that statement being included in the form and context in which it appears: s716(2) and 1013K. This requirement applies to an issuer citing a credit rating in a disclosure document or PDS.
 

Note: A disclosure document includes a prospectus, profile statement and offer information statement: s9
- 2 There are equivalent requirements for bidder's and target's statements in takeovers: s636(3) and 638(5).
- 3 This 'consent to quote' requirement allows persons whose statements are being cited to:
  - (a) control the effect of a statement in the context of the disclosure document or PDS as a whole; and
  - (b) control their liability.
- 4 A person whose statement is cited in a disclosure document or PDS with their consent is generally liable for loss or damage caused by the relevant statement: item 5 of s729(1), 1022B(2) and 1022B(3)(c). The Explanatory Memorandum to the *Corporate Law Economic Reform Program Act 1999* stated:
 

A person will need to have consented to being named in the disclosure document in relation to a statement ... before any liability may arise.

## Current relief to cite credit ratings without consent

- 5 We previously gave class order relief for issuers to cite credit ratings from Standard & Poor's, Moody's Investor Service and Fitch Ratings in a disclosure document or PDS without the consent of credit rating agencies: see Regulatory Guide 55 *Disclosure documents and PDS: consent to quote* (RG 55), re-issued in March 2007. We had given case-by-case relief to cite credit ratings from the mid-1990s.

Note: See Class Order [CO 07/428] *Consent to quote: Citing credit ratings, trading data and geological reports in disclosure documents in PDS*. For equivalent takeovers relief, see Class Order [CO 07/429] *Consent to quote: Citing credit ratings agencies, trading data and geological reports in takeovers*.

- 6 [CO 07/428] applies to an opinion on the creditworthiness of an issuer or the ability of the issuer to meet its obligations under a financial product. It applies where the product is:
- (a) a debt product;
  - (b) a hybrid product (i.e. a product that combines both debt and equity characteristics, such as a convertible note or a redeemable preference share); or
  - (c) an equity security of an Australian authorised deposit-taking institution (ADI) or option or warrant over such a security.

- 7 It is a condition of the relief that the disclosure document or PDS includes statements that:
- (a) the rating is current;
  - (b) the rating is not a recommendation to apply for the product;
  - (c) the rating is subject to revision or withdrawal at any time; and
  - (d) all current ratings that are known to the issuer are included.

RG 55 states that we expect that the issuer will prominently explain the meaning of the credit rating (e.g. that it relates only to creditworthiness).

- 8 The current Australian position is consistent with that in the United States. Currently in the United States, credit rating agencies are exempt from liability as an expert cited in a registration statement with its consent: *Securities Act 1933* (US), s11 and rule 436(g).

## Licensing of credit rating agencies in Australia

- 9 Currently, we give relief to Standard & Poor's, Moody's Investor Service and Fitch Ratings from the requirement to hold an AFS licence on the basis of compliance with the International Organization of Securities Commissions Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Code): see Class Order [CO 05/1230] *Credit rating agencies*.

- 10 ASIC will revoke [CO 05/1230] by 1 January 2010, requiring credit rating agencies to obtain an AFS licence.
- 11 When a credit rating agency obtains an AFS licence, the licence will include conditions requiring the credit rating agency to:
- (a) comply with the IOSCO Code (revised in May 2008);
  - (b) give an annual report on compliance with the IOSCO Code;
  - (c) disclose its methodologies, assumptions and procedures resulting in a credit rating;
  - (d) have adequate processes for keeping a credit rating current; and
  - (e) consent to ASIC sharing information about the credit rating agency with regulators overseas.
- 12 Following the regulation on credit rating agencies passed by the European Parliament in April 2009, ASIC is conducting further discussions with each rating agency and with industry on European and other international developments and the implications for their Australian business and Australian licensing.

### **Implications for issuers**

- 13 Issuers planning to include a credit rating in offers or advertising of debt, hybrid debt equity or structured finance products from 1 January 2010 will need to check whether the credit rating agency is licensed and whether they have a retail or wholesale authorisation.

## B Proposal to withdraw consent to quote relief

### Key points

We are considering whether to withdraw our existing class order relief under [CO 07/428] for issuers to cite credit ratings without consent in disclosure documents and PDSs.

Our reasons for giving relief originally were that credit ratings would assist investors to make a better-informed decision but obtaining consent was impractical.

We are reviewing this relief to strengthen credit rating agencies' control over the use of their ratings and to make credit rating agencies more accountable to investors for ratings.

### Why did we give relief?

- 14 We gave consent to quote relief for credit ratings on the basis that:
- (a) credit ratings would assist investors to make a better-informed decision; and
  - (b) it was impractical to obtain consent from credit rating agencies. Without relief, the consent to quote requirement would mean credit rating agencies need to look at each disclosure document or PDS that cited a rating to decide whether to consent to the inclusion of its rating in the form and context in which it appeared. None of the three credit rating agencies had a policy of reviewing each disclosure document or PDS.

Note: See RG 55 (at RG 55.64–RG 55.67) for further discussion of the factors we generally take into account in giving relief from the consent to quote requirement.

### Why are we reviewing relief?

- 15 We are reviewing our class order relief in light of the global financial crisis. As liability for the content of disclosure documents and PDSs only attaches to persons who have consented to having their statements cited, our class order has implications for the accountability of credit rating agencies to investors.
- 16 However, withdrawing consent to quote relief may mean it is impractical for issuers to include credit ratings in disclosure documents and PDSs, which will result in retail investors not being informed about the credit rating.



## Control over use of credit ratings

- 17 Control over how credit ratings are used in disclosure documents and PDSs and the effect of the statement is particularly important because of the specific role of credit ratings.
- 18 Credit ratings are opinions specifically about the relative credit risk of debt and structured finance products. They are not opinions about volatility risk or liquidity risk. Nevertheless, credit ratings can still be relevant to decisions to invest in these products.
- 19 Credit rating agencies themselves have argued that investors have over-relied on credit ratings and used them for purposes for which they were not intended. Various reports and reviews also identify over-reliance by wholesale investors as a problem.
- Note: See, for example, G20 Working Group 1, *Enhancing sound regulation and strengthening transparency*, Final Report, March 2009, p. 32; SEC, *Proposed Rules: references to ratings of NRSROs*, July 2008, p. 3; EU, *Proposal for a Regulation of the European Parliament on Credit Rating Agencies*, Explanatory Memorandum, November 2008, p. 2; and IOSCO Technical Committee, *The role of credit rating agencies in structured finance markets*, Final Report, May 2008, pp. 8–9.
- 20 Credit rating agencies have also argued that ratings are not prepared with retail investors in mind. Again, this does not mean that credit ratings are irrelevant to decisions made by retail investors in relation to debt or structured finance products. Credit risk in such products applies to retail investors in the same way it does to wholesale investors.
- 21 Our consent to quote relief under [CO 07/428] recognises the specific role of credit ratings—for example, by requiring the disclosure document or PDS to prominently explain the credit rating and state that the rating is not a recommendation to apply for the product.
- 22 Credit rating agencies can currently control issuers' use of their credit ratings—for example, by intellectual property licensing. By withdrawing our relief, we would allow credit rating agencies to also control the use and presentation of their ratings in a disclosure document or PDS by giving or withholding consent.

### Proposal

- B1** We are considering revoking our class order relief from s716(2) and 1013K so that issuers would be required to obtain the consent of credit rating agencies to include credit ratings in disclosure documents and PDSs in the form and context in which the ratings appear. We are also considering whether to revoke equivalent relief for bidder's and target's statements.

*(please see next page for feedback questions)*

*Your feedback*

- B1Q1 How important are credit ratings to retail investors in making an informed decision to invest in debt, hybrid debt equity or structured finance products?
- B1Q2 How important are credit ratings to retail investors in making an informed decision to invest in equity securities offered by an Australian ADI (i.e. a bank)?
- B1Q3 If credit ratings were not included in disclosure documents and PDSs, how would retail investors form a view on credit risk?
- B1Q4 How common is the use of credit ratings in disclosure documents and PDSs? Please provide details.
- B1Q5 How common is the use of credit ratings to advertise the offer of financial products?
- B1Q6 How well are the requirements in [CO 07/428] working for issuers to disclose the role of credit ratings in the disclosure document and PDS?
- B1Q7 If you are a credit rating agency, do you currently control the use of credit ratings in disclosure documents, PDSs and advertising of financial products? If so, how?
- B1Q8 Would it be practical for a credit rating agency to consent to an issuer citing credit ratings in each disclosure document or PDS in the form and context in which the rating appears?
- B1Q9 What costs for issuers and credit rating agencies would be involved in obtaining consent to cite credit ratings? Please provide detail and quantify those costs, if possible.
- B1Q10 How useful are credit ratings included in a disclosure document or PDS that give an opinion about the creditworthiness of the issuer of a product (as opposed to credit ratings of the product itself)? Are credit ratings for certain categories of issuers (e.g. banks or insurers) more useful than others?
- B1Q11 Do retail investors place undue weight on credit ratings? Please provide reasons for your answer.

## C Regulatory and financial impact

- 23 In reviewing our consent to quote relief we will carefully consider its regulatory and financial impact and the balance between:
- (a) making credit ratings available to retail investors; and
  - (b) promoting the accountability of credit rating agencies to investors and control of credit rating agencies over the use of their ratings.
- 24 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:
- (a) considering all feasible options;
  - (b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
  - (c) if our proposed option has more than a low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
  - (d) conducting the appropriate level of regulatory analysis—that is, by completing a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).
- 25 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 26 To ensure that we are in a position to properly complete any required BCC report or RIS, we ask you to provide us with as much information as you can about our proposals or any alternative approaches including:
- (a) the likely compliance costs;
  - (b) the likely effect on competition; and
  - (c) other impacts, costs and benefits.

See ‘The consultation process’, p. 4.

## Key terms

Term	Meaning in this document
IOSCO Code	International Organization of Securities Commissions Code of Conduct Fundamentals for Credit Rating Agencies
[CO 07/428]	An ASIC class order, in this example numbered 07/428
consent to quote requirement	Prohibition against an issuer citing a statement made by a person in a disclosure document or PDS unless the person has consented to that statement being included in the form and context in which it appears under s716(2) and 1013K
disclosure document	For an offer of securities, this includes a prospectus, a profile statement and an offer information statement.
PDS	A product disclosure statement
RG 55	An ASIC regulatory guide, in this example numbered 55