



ASIC

Australian Securities & Investments Commission

REPORT 268

Response to submissions on CP 160 Credit rating agencies: IOSCO Code Annual Compliance Report

December 2011

About this report

This report highlights the key issues that arose out of the submissions to Consultation Paper 160 *Credit rating agencies: IOSCO Code Annual Compliance Report* (CP 160) and details our responses in relation to those issues.

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.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

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A Overview/Consultation process

- 1 In Consultation Paper 160 *Credit rating agencies: IOSCO Code Annual Compliance Report* (CP 160), we consulted on proposals for the form and content of annual compliance reporting by licensed credit rating agencies under their Australian financial services (AFS) licence conditions.
- 2 AFS licences granted to credit rating agencies contain a condition requiring that they submit a compliance report to ASIC annually and on request.
- 3 ASIC can specify in writing the information, statements, explanations or other matters that credit rating agencies must include in their compliance report relating to compliance with the International Organization of Securities Commissions (IOSCO) Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Code) and AFS licence conditions on training and arrangements to monitor and update credit ratings.
- 4 In CP 160, we proposed specifications for the compliance report, including:
 - (a) the proposed content of the compliance report;
 - (b) the aspects of the report that should be made available to the public; and
 - (c) the form of the compliance report.
- 5 This report highlights the key issues that arose out of the submissions received to CP 160 and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 160. We have limited this report to the key issues.

Responses to consultation

- 7 We received a total of five responses to CP 160 from credit rating agencies and the Australian Bankers' Association.
- 8 The submissions were generally supportive of the proposals in CP 160. Generally, issues raised in the submissions were common to the majority of respondents. The main change suggested related to the proposed requirement for reporting planned compliance measures.
- 9 Common concerns were raised in all of the submissions about the aspects of the compliance report that would be made publicly available.
- 10 After considering the submissions, we have adopted the form of report proposed in CP 160 with some minor changes to the required content: see Appendix 1 for a sample letter outlining the specifications for the report.

- 11 For example, credit rating agencies will not be required to report planned measures. However, they should disclose the following information to the public:
- (a) a list of the credit rating agency's ancillary businesses;
 - (b) a list of its actual or potential conflicts of interest; and
 - (c) hyperlinks to information that is required to be made public under the IOSCO Code.
- 12 We will not require public disclosure of other confidential information contained in the compliance report. For more details, see Section C of this report.
- 13 For a list of the non-confidential responses to CP 160, see Appendix 2. Copies of the non-confidential submissions are published on the ASIC website at www.asic.gov.au/cp under CP 160.

B Content of the compliance report

Key points

In CP 160, we proposed content specifications for the compliance report and asked for comments on those specifications.

We have specified content for the compliance report that is substantially similar to the proposed content in CP 160, with a few minor amendments in response to submissions and to clarify some of the requirements.

We will not require credit rating agencies to include information about planned compliance measures or policies in their compliance reports.

Requirement for planned measures

- 14 In CP 160, we proposed that credit rating agencies describe in their compliance report any implemented or planned measures that have the aim of ensuring compliance with the IOSCO Code provisions or certain AFS licence conditions.
- 15 Many of the respondents questioned the usefulness of information about planned measures that may change before implementation or may never be implemented at all.
- 16 A concern was also raised that a requirement to report on planned measures would be beyond the scope of the AFS licence conditions, as planned measures do not relate to compliance with these conditions.

ASIC's response

We will require credit rating agencies to describe their implemented compliance measures or policies but will not require description of planned measures.

We accept that information about planned measures may be of limited value to ASIC as the planned measure may not be implemented or may be implemented in a modified form.

ASIC has extensive powers to gather information about planned measures if and when such information is needed.

Requirement to explain any failings

- 17 In CP 160, we proposed that credit rating agencies identify in their compliance report any failings of measures against their aims and explain how those failings have been or will be addressed.

- 18 A few respondents raised concerns that a requirement to identify ‘any failings’ of the measures against their aims (even if insignificant) and explain how those failings have been or will be addressed would be too onerous.
- 19 Some respondents also felt this requirement was unnecessary because reporting of any significant breach or likely breach is already required under s912D of the *Corporations Act 2001* (Corporations Act).

ASIC’s response

We will require credit rating agencies to describe in their compliance report any failings of measures against their aims and to explain how those failings have been or will be addressed.

There are differences between this requirement and the breach reporting requirements under s912D.

Breach reporting relates to significant breaches of general licensee obligations under s912A, whereas in the compliance report, a credit rating agency is required to give a description of the failing of a compliance measure against its aim and an explanation of how it has or will be addressed.

Number of topics, repetition and response length

- 20 Some submissions sought clarification about how the potential for overlap in a credit rating agency’s description of its compliance measures, or the review and testing of compliance with IOSCO Code provisions, should be addressed in the compliance report to avoid unnecessary repetition.
- 21 One respondent also expressed a view that restricting responses to a maximum of four pages per topic may curtail a credit rating agency’s ability to provide a full response to certain topics in its compliance report.

ASIC’s response

We have clarified that a credit rating agency’s response on a topic in its compliance report may cross-reference to responses on other topics where relevant.

In CP 160, the proposed instructions for the compliance report explain that the page limit may be exceeded where reasonably justified by the complexity of the description or topic. Exceeding the limit is more likely to be justified in the first compliance report by a credit rating agency, as subsequent reports need only address matters and changes arising since the previous report.

In any case, to address this issue, we have increased the limit to a maximum of five pages for each topic, except where exceeding this limitation is reasonably justified by the complexity of the description or topic.

C Public and private disclosure

Key points

In CP 160, we asked for feedback about whether any aspects of the proposed compliance report should not be made available to the public.

Aspects of the compliance report that are not confidential and which should be disclosed to the public are:

- a list of the credit rating agency's ancillary businesses;
- a list of the its actual or potential conflicts of interest; and
- information that is required to be made public under the IOSCO Code.

Other aspects of the compliance report that may involve confidential information must be reported to ASIC, but disclosure to the public will not be required.

Protecting commercially-sensitive or confidential information

- 22 All respondents raised common concerns about the protection of commercially-sensitive or confidential information from public release. Many credit rating agencies suggested that they would have to restrict the information provided in the compliance report if the entire report was to be disclosed to the public.
- 23 Respondents submitted that confidential information that should not be disclosed to the public includes information about resourcing, compliance testing, reviews or failures of compliance measures. If forced to disclose the measures and internal policies described in the compliance report to the public, credit rating agencies requested that they be permitted to censor the information wherever disclosure could potentially breach confidentiality.

ASIC's response

There are aspects of the compliance report that are not confidential, including information that is required to be disclosed in accordance with the IOSCO Code. Among other things, this includes a description of the credit rating agency's rating methodologies and assumptions, its conflict avoidance and management measures, the general nature of its compensation arrangements and its historical ratings performance statistics.

We have specified that a list of a credit rating agency's ancillary business and a consolidated list of potential and actual conflicts should be made available to the public.

We have also required that a list of hyperlinks to publicly-disclosed information be provided, so we can ensure the information is presented appropriately and is readily accessible.

We will not require public disclosure of other confidential information contained in the compliance report.

For information given to us in confidence or in connection with the performance of our functions or the exercise of our powers, we are required under s127 of the *Australian Securities and Investment Commission Act 2001* (Cth) to take all reasonable measures to protect such information from unauthorised use or disclosure.

We accept the submissions from credit rating agencies that some information to be included in the compliance report would contain commercially-sensitive information or information that is subject to confidentiality agreements with issuers. For example, information about a credit rating agency's compliance measures, resources, results of compliance testing and failure of measures would be confidential in most cases.

It is important that the compliance report deliver information (including confidential information) that will help us to assess compliance by a credit rating agency with the provisions of the IOSCO Code and its AFS licence conditions. To facilitate open and candid compliance reporting by credit rating agencies, we will maintain the confidence of information provided to us in compliance reports.

D Form of the compliance report

Key points

Respondents were supportive of the form of compliance report proposed in CP 160 and did not see merit in:

- a simpler report which merely required certification from a credit rating agency that it had complied with its AFS licence conditions;
- a report that required more detailed responses for each individual provision of the IOSCO Code; or
- a report similar to that required in the European Union (EU) or the United States (US).

Other forms

- 24 There was no support for a simpler report that would merely require certification from a credit rating agency that it has complied with its AFS licence conditions. Respondents acknowledged that ASIC would be likely to supplement the limited information contained in a certification report with additional requests and notices to produce further information, which would lead to greater uncertainty, inefficiency and disruption to their businesses. Some submissions also expressed concern that a certification report would not be equivalent to the reporting and disclosure requirements in the EU.
- 25 Similarly, all respondents opposed a report requiring detailed responses for each individual provision of the IOSCO Code.
- 26 Respondents highlighted the burden of having to produce such a detailed report, feeling it would outweigh any potential benefits, given that many policies and procedures relate to more than one IOSCO Code provision. Any report that sought to separate out the discussion of these measures to individual provisions would lead to duplication and a significant level of cross-referencing between responses.
- 27 International credit rating agencies commented that there was very limited scope to gain efficiencies from their compliance with reporting requirements in the EU and the US. They explained that those regulatory reports are specifically tailored to regulation of credit rating agencies in the EU and US and their businesses located in those jurisdictions. For these reasons, they submitted it would not be appropriate for Australia to base the compliance report on the EU reporting requirements. In Australia, credit rating agencies must comply with the conditions of their AFS licences and the financial services laws, which are unique to Australia.

ASIC's response

We have adopted the form of compliance report proposed in CP 160.

We consider that the compliance report will deliver sufficient, but not excessive, information. Taking into account the submissions, we remain of the view that the compliance report finds an appropriate balance between:

- (a) delivering the information we need to help us assess compliance by a credit rating agency with the provisions of the IOSCO Code and its AFS licence conditions;
- (b) the likely costs of preparing the report; and
- (c) consistency with international regulatory approaches to reporting by credit rating agencies.

After we have reviewed the compliance report, any areas identified for further consideration will be explored as part of our ongoing monitoring and oversight.

See Appendix 1 for a sample letter outlining specifications for the compliance report.

Appendix 1: Sample letter outlining specifications for the compliance report

The following is a sample letter to a credit rating agency, specifying the form and content of the compliance report.

The Australian Securities and Investments Commission (ASIC) refers to:

- (a) s912A(1)(b) of the *Corporations Act 2001* (Corporations Act), requiring [*the licensee*] to comply with the conditions of its AFS licence; and
- (b) condition 3 [*or 4 if the licence contains a key person condition*] of the licensee's AFS licence, requiring it to give to ASIC a report (Report) that includes the information, statements, explanations or other matters specified by ASIC in writing relating to your compliance with conditions 2, 4, 5 and 6 [*or 3, 5, 6 and 7 if the licence contains a key person condition*] for the following periods:
 - (i) for each financial year, at the same time the licensee is required to lodge a balance sheet under Part 7.8 of the Corporations Act; and
 - (ii) for any period of time that ASIC requests, by the date ASIC reasonably requests in writing the Report to be lodged.

This letter specifies the information, statements, explanations or other matters that must be included in each such Report given to ASIC.

General instructions

The licensee's report must address 11 topics (listed below) drawn from the Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Code) issued by the Technical Committee of the International Organization of Securities Commissions in May 2008 and the licensee's AFS licence conditions.

IOSCO Code topics

1. Quality and Integrity of the Rating Process—Quality of the Rating Process;
2. Quality and Integrity of the Rating Process—Monitoring and Updating;
3. Quality and Integrity of the Rating Process—Integrity of the Rating Process;
4. CRA Independence and Avoidance of Conflicts of Interest—General;
5. CRA Independence and Avoidance of Conflicts of Interest—CRA Procedures and Policies;
6. CRA Independence and Avoidance of Conflicts of Interest—CRA Analyst and Employee Independence;
7. CRA Responsibilities to the Investing Public—Transparency and Timeliness of Ratings Disclosure;
8. CRA Responsibilities to the Investing Public—The Treatment of Confidential Information;
9. Disclosure of the Code of Conduct and Communication with Market Participants;

AFS licence condition topics

10. Arrangements to Monitor and Update Credit Ratings;
11. Training Requirements for Representatives.

For each of these 11 topics, the licensee's report must provide a narrative description of any implemented measures that have the aim of ensuring compliance with the associated IOSCO Code provisions or AFS licence conditions.

The licensee's description should:

- (c) for each topic, be no more than five pages in length, except where exceeding this limitation is reasonably justified by the complexity of the description or topic;
- (d) include an explanation of how the relevant measure ensures, as far as is reasonably practicable, compliance with the associated IOSCO Code provisions or AFS licence conditions;
- (e) describe the resources, including the internal compliance resources, allocated to the measures;
- (f) describe any testing and reviews of the measures that have been or will be conducted and the results of those tests and reviews;
- (g) where a measure necessarily involves the disclosure of information (e.g. because the disclosure is mandated by the IOSCO Code), include a hyperlink to such disclosed information. This information should be available to the public;
- (h) describe any failings of the measures against their aims and explain how those failings have been or will be addressed;
- (i) identify by name any existing policies or similar documents;
- (j) for Topic 4 CRA Independence and Avoidance of Conflicts of Interest—General – include a list of ancillary businesses that the licensee operates and an explanation of why it considers these businesses to be ancillary businesses. This information should be available to the public;
- (k) for Topic 5 CRA Independence and Avoidance of Conflicts of Interest—CRA Procedures and Policies – include an attachment listing any actual or potential conflicts of interest that may influence the opinions and analyses the licensee makes or the judgement and analyses of the individuals the licensee employs who have an influence on ratings decisions. This information should be available to the public; and
- (l) only address any measure that has been implemented, or any failing that has occurred, since your previous Report.

Where relevant, your response to a topic may cross-reference your responses to other topics.

Signature

The Report must be signed by a director of the licensee and the licensee's compliance manager, each declaring that the Report is accurate and fairly represents all the matters that must be included in the Report, as specified in this letter.

Delivery of Reports

The licensee's Reports may be delivered to any of ASIC's service centres or posted or emailed to the following addresses:

The Senior Manager
Investment Banks Team
GPO Box 9827
In your capital city

CRAreports@asic.gov.au

Record keeping

We expect the licensee to keep records to support any answer it provides as part of its Report. The licensee may be required to produce such records on demand.

Timing

The licensee's Report in respect of the year ended [*the licensee's financial year end*] must be given to ASIC by [*a date four months after the licensee's financial year end*].

Appendix 2: List of non-confidential responses

Australian Bankers' Association Inc.

Standard & Poor's (Australia) Pty Ltd