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British Colombia Securities Commission
Alberta Securities Commission
Ontario Securities Commission
Autorite des marches financiers, Quebec

Re: CSA Consultation Paper 11-405
CSA Proposal No 1: The CRA Framework

Dear Sirs,

Fitch Ratings ("Fitch") submits this letter in response to the request for comments of the Canadian Securities Administrators (the "CSA") on the *Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil and its Effect on the ABCP Market in Canada* (CSA Consultation Paper 11-405). Set forth below are our comments on Proposal Number 1 of the Consultation Paper – the rules applicable to credit rating agencies ("CRAs"), ("the Proposed Rules"). For the convenience of the CSA, we have followed the section order used by the CSA in the Proposed Rules. We have only discussed those parts of the Proposed Rules about which we have specific questions or concerns.

Section F: Features of the CRA Framework

We recognise that regulatory authorities have a legitimate interest in monitoring compliance by CRAs with the IOSCO Code of Conduct Fundamentals for CRAs (the "IOSCO Code"). Currently, there are a number of regulatory bodies throughout the world considering various ways to provide formal oversight for CRAs, including proposals being considered by IOSCO and in the European Union, Australia and Japan. In principle, Fitch believes that the optimal result of this process for all interested parties – regulators, issuers, investors, market participants and CRAs – is a harmonised global system of oversight for CRAs, based on the IOSCO Code and related principles.

We therefore welcome the CSA's position that Canada should base its framework for the regulation and supervision of CRAs on the IOSCO Code. We consider such an approach to be appropriate and practical given the global nature of our business. We note, however, that, as currently drafted, certain provisions within Section F of the Proposed Rules are unclear with regard to the standards required of CRAs and the penalties to be imposed for violating those standards. Furthermore, some provisions are at odds with the core IOSCO principle of CRA independence. We expand on these concerns below.

We note that the core requirement of the Proposed Rules is that the CRAs comply with the "comply or explain" provision of the IOSCO Code. We are therefore confused by the second major bullet point within the additional provisions, which states that *"Securities regulators would have the authority to make orders in the public interest that impose terms and conditions on the conduct of business of an approved credit rating organization […]."* Similarly, we are concerned by the fifth major bullet point within the additional provisions, which states that *"An approved credit rating organization could be required to make any changes to its practices and procedures relating to its business as a CRA that are ordered by securities regulators."*

We strongly believe that the cornerstone of any regulatory approach with respect to CRAs should be an acceptance by the regulator that its supervision should not, in any way, intrude, or appear to intrude, into the actual substance of opinions determined by the CRAs or the content or choice of rating methodology. Regulation should concern oversight of the processes used to assign ratings.

CRA independence has been the conclusion of the drafters of legislation in all major market jurisdictions that currently have some form of regulation of CRAs in place. As the CSA is aware, independence is also one of the six core criteria that a CRA must meet to be recognized as an external credit assessment institution for the purposes of Basel II. We believe that this independence is what the market wants. Users of ratings value them precisely because ratings are independent, unaffiliated views. We therefore propose that, in the text of the Proposed Rules, the CSA makes this commitment to non-interference clear through a prohibition on the ability of the CSA or any other public body to "regulate the substance of credit ratings or the procedures and methodologies by which any [CRA] determines credit ratings."[1] This is the language that the U.S. Congress decided was appropriate to protect the independence of CRAs and we suggest that it is also appropriate to make a similar statement in Canada.

On the same theme, while we accept that there should be meaningful sanctions imposed on rating agencies that are effective, proportionate and dissuasive, we believe that such sanctions should be explicitly defined within the Proposed Rules, and should be imposed solely in response to a material violation of the Proposed Rules – in the case of the CSA proposals, a failure to comply with the "comply or explain" provision of the IOSCO Code. CRAs should not be subject to penalties for violating additional ambiguous standards based on "the public interest".

Using the public interest as a yardstick by which to judge the behaviour of CRAs, without any further clarity as to what is intended, could place conflicting burdens on our industry. If, for example, a CRA determines that the rating of a bank should be downgraded based on a deterioration in the bank's financial condition, the downgrade could arguably be viewed as being against the public interest. In such a situation, the CSA could be deemed to have a basis under the Proposed Rules to take action against the CRA. This ability in turn might prevent the CRA from taking needed and appropriate rating action. Such a situation seems to be contrary to Section 2.1 of the IOSCO Fundamentals, which specifies that: *"A CRA should not forbear or refrain from taking a rating action based on the potential effect (economic, political, or otherwise) of the action on the CRA, an issuer, an investor, or other market participant."*

[1] The Credit Rating Agency Reform Act of 2006, Section 15E of the US Securities Exchange Act of 1934.

Finally, in addition to our observations that the standards imposed on CRAs should be unambiguous and based on the IOSCO Code, and that the penalties to be imposed for violating these standards should be clearly defined within the Proposed Rules, we would also highlight the need for due process. The Proposed Rules should note that before any penalty is imposed on a rating agency, the rating agency should be notified and granted an appropriate opportunity to answer any such concerns and/or take remedial action to correct any issues.

Section G: Disclosure of Information Provided to CRAs

Fitch has advocated for some time that there should be increased public disclosure with respect to structured finance products to assist investors in conducting their own investment analysis. This would directly address the concern expressed by the CSA, and other regulators throughout the world, that investors have become too reliant on ratings when investing in structured finance products, rather than using ratings as just one tool in their analysis. In order for the information to be of use to investors, it must be provided in a timely fashion, and must be complete and detailed.

We agree with the CSA that an additional benefit of the disclosure of such data would be the ability for any CRA to express its views as to the merits of the relevant structured finance product whether or not it was requested to rate the product. We also agree that this could assist in preventing "ratings shopping" by issuers and significantly increase market commentary from a wider variety of sources – both CRAs and other publishers. We believe, however, that the primary purpose of such disclosure must be to increase the information flow to investors. By proposing this Rule, we believe that the CSA is acknowledging that the information to be disclosed is material to the investors' investment decision. We agree, but believe the CSA has chosen the wrong means to accomplish the goal of enhanced disclosure to investors.

In its commentary with respect to this Proposed Rule, the CSA accepts that it *"would put the onus on the CRAs rather than on issuers to ensure disclosure of information about asset-backed securities."* Fitch strongly believes that such an approach would be inappropriate. Since the information is kept and/or produced originally by the issuers, arrangers and/or trustees of structured products, it would seem more appropriate and logical for the CSA to impose any requirement to publish such information directly on the issuers, arrangers and/or trustees.

While the CSA Proposed Rule does not specify that the CRA must be the party to disclose the information, it appears that the CSA intends to impose on the CRA a duty to require issuers, arrangers and/or trustees to disclose the relevant information in accordance with the Proposed Rules, and somehow to enforce this requirement. We respectfully submit that it is inconsistent for the CSA to be concerned that CRAs not act as gatekeepers within the securities markets, yet at the same time expect CRAs to police disclosure of material information by third parties – especially given that CRAs have no effective power to police any such disclosure requirement. We, therefore, strongly believe that the CSA should require that the issuers, arrangers and/or trustees of structured products disclose publicly all information that they have provided to any CRA before such time as investors make their investment decisions.

We note that the CSA intends to take into consideration any changes in similar rules being proposed in the United States by the SEC. Since amendments to the relevant rule (Rule 17g-5 with respect to the Credit Rating Agency Reform Act of 2006) have been re-proposed, we hope that these changes will be taken into consideration by the CSA before it finalises its own rules

on this topic. We respectfully request that if the CSA does not decide to impose a public disclosure duty directly on the issuers, arrangers and/or trustees of structured products, it will consider amending the final version of the rules so that they are consistent with the requirements imposed on NRSROs by the SEC. As we have already noted, our business is a global one and we will find it difficult and burdensome to adhere to different rules and regulations in different jurisdictions.

If the CSA decides to stick with its current position and require that CRAs must disclose this information, then we submit that the CSA should modify the Proposed Rule to: (i) explicitly recognise that a CRA can address the disclosure requirement by obtaining a representation from the party requesting the rating that it will disclose, or cause to be disclosed, to investors all information provided to the CRA for use by the CRA in its rating analysis, (ii) make clear that the CRA has no obligation to verify whether the third party has complied with the representation, since CRAs will not be in a position to verify compliance or impose sanctions for failure to comply, and (iii) specify that the CRAs have no liability with respect to the actual disclosure and/or the contents of the disclosure.

Thank you for giving us the opportunity to provide our comments. We hope you find them useful, and that you will give them due consideration. Please do not hesitate to contact me in London on +44 20 7417 6341, sharon.raj@fitchratings.com or my colleague, Susan Launi, Senior European Counsel, in London on +44 20 7682 7470, susan.launi@fitchratings.com, should you wish to discuss this matter further.

Yours sincerely,

Sharon Raj
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Fitch Ratings