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British Columbia Securities Commission
Alberta Securities Commission
Ontario Securities Commission
Autorité des marchés financiers

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c/o Me Anne-Marie Beaudoin
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Re: Securities Regulatory Proposals Stemming from the 2007-2008 Credit Market Turmoil and its Effect on the ABCP Market in Canada – Consultation Paper of The Canadian Securities Administrators – "CSA Consultation Paper 11-405"

Dear Sirs / Mesdames :

1. Introduction

1.1 Standard & Poor's Ratings Services ("S&P") welcomes the opportunity to comment on the "*Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil and its Effect on the ABCP Market in Canada*" in response to the consultation paper of October 2008 (the "Consultation Paper") issued by the Canadian Securities Administrators ("CSA") and its ABCP Working Group ("the Committee").

1.2 We set out below our comments on the Consultation Paper, focusing on those aspects of the proposals that relate directly to the work of credit rating agencies ("CRAs") and the use of credit ratings. In section 2 below, we comment briefly upon the remarks that the Committee has made about the role of CRAs in the credit crisis. In the subsequent sections, we set out our comments on CSA proposals #1, 3 and 4. We do not comment directly on proposals #2, 5, 6 and 7 although some of the comments that we make on the other proposals may to some extent also be applicable to these proposals.

2. **The Role of Credit Rating Agencies in the Credit Turmoil**

2.1 We note that the Consultation Paper contains, within Part 1, a discussion of the Committee's view on the role of CRAs in the context of the current credit turmoil. Although we do not wish to comment in detail on those issues (because that is not the purpose of this response), we would comment as follows:-

(a) S&P recognises the existing concern about CRAs' potential conflicts of interest. We have longstanding policies and practices that address potential conflicts and how we disclose and manage them. Many of these are contained in S&P's Code of Conduct, initially issued in October 2005 and updated in December 2008[1] – both based on IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies ("IOSCO Code")- and previously were contained in our Code of Practices and Procedures. Our longstanding policies include not remunerating analysts based on the fees paid by issuers they directly rate and requiring that all ratings decisions are assigned by committees.

(b) Furthermore, in February 2008 we announced a set of 27 different initiatives that were designed to strengthen our ratings process and address analytics, governance, independence and investor education.

(c) The Consultation Paper refers to the SEC report published in July 2008, which summarised issues identified in examinations in the United States of S&P and two other nationally recognized statistical rating organizations ("NRSROs"). At the conclusion of the examination, the SEC made a series of recommendations and we are taking action, as a recently regulated NRSRO, to implement those. Nevertheless, we must stress that the SEC itself concluded that it had found no evidence during its examination that S&P had made decisions about rating methodologies or models based on attracting or losing market share.

2.2 In the particular context of the current Consultation Paper, we would also highlight that prior to 2008 S&P did not rate Canadian ABCP. This was primarily due to our criteria perspective on the nature of liquidity facilities supporting ABCP in Canada. By not rating these instruments we let pass a commercial opportunity, but we maintained our position because we were not prepared to compromise on our analytical view. We were also very transparent in publicising our analytic views in the hope that this would help to reconcile Canadian liquidity structures with globally recognised standards (for example, we set out our views in a paper entitled "*Leap of Faith: Canadian Asset-Backed Commercial Paper often lacks liquidity backup*" dated 1 August 2002). Notwithstanding these efforts, the longstanding liquidity conventions in Canada remained, until recently, a fundamental obstacle to increased ratings coverage of the Canadian ABCP sector.

2.3 Against this background, S&P is pleased to note that the Committee has itself concluded that CRAs did not cause the credit turmoil and that it is unlikely that regulating CRAs would have prevented it. Nevertheless, S&P believes that the CSA proposal to implement a regulatory framework for CRAs could, if appropriately calibrated, support efforts to rebuild confidence in ratings.

2.4 To be effective, we believe that the regulatory framework must contribute to the CRAs producing high quality, independent, and internationally consistent credit ratings for the market. We can comment further on those issues once more detailed proposals are available, but in the meantime we comment below on certain of the specific proposals in the Consultation Paper.

[1] http://sp.mhf2.mhf.mhc/documents/view_one.cfm?ID=24&menuID=5488

3. **CSA proposal #1: establishing a regulatory framework**

The Committee proposes establishing a regulatory framework applicable to "approved credit rating organizations" that requires compliance with the "comply or explain" provision of the IOSCO Code of Conduct and provides securities regulators authority to require changes to a CRA's practices and procedures.
The Committee will also consider whether to require public disclosure of all information provided by an issuer that is used by a CRA in rating an asset-backed security.

The use of the IOSCO Code

3.1 In general, S&P supports the proposal to establish a regulatory framework that would require compliance with the *"comply* or *explain"* provisions of the IOSCO Code. The IOSCO Code is widely supported as an internationally recognised standard so that it provides a platform for national regulators to promote standards that will be consistent at an international level. This is particularly important for a global rating agency such as S&P because many of the securities we rate are traded on exchanges in more than one country and held by investors globally. All of our ratings are issued under one S&P brand and there is close collaboration between ratings analysts based in different countries. It is therefore important that we are able to operate as a global business under a set of international standards that are based on the IOSCO Code.

3.2 Another advantage of the IOSCO Code is that it is flexible in that it can evolve to meet new challenges. As noted above, it was amended in May 2008 to reflect events related to the credit crunch. By using the IOSCO Code as a benchmark, any Canadian regulatory framework can adopt a set of standards that are likely to remain up-to-date without the need for formal amendment through further legislation.

3.3 We also endorse the Committee's proposal to incorporate the "*comply or explain*" provisions of the IOSCO Code. Under the "*comply or explain*" regime, CRAs have a degree of flexibility in how to adopt the different aspects of the Code into their individual codes of conduct. CRAs are required to explain if their own codes deviate from the IOSCO Code and to explain how they nevertheless achieve the objectives laid out in the Code. We believe this is the correct model for regulation in that it compels CRAs to meet the objectives stipulated in the IOSCO Code while at the same time allowing them to tailor their procedures to take account of their particular corporate structures, business models and markets. S&P itself maintains procedures that meet the objectives of the Code, but which adopt different approaches in a few areas where we have concluded that the Code does not fit our practices or organizational structure.

The imposition of further terms and conditions on approved credit rating organizations

3.4 The Consultation Paper proposes that securities regulators "*would have the authority to make orders in the public interest that imposed terms and conditions on the conduct of business of an approved credit rating organisation*". It also states that:

> "*An approved credit rating organisation 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.*"

3.5 These provisions cause us considerable concern. Any system of regulation should in our view provide certainty on the standards a regulated entity has to meet and the practices it is expected to follow. We would respectfully submit that the language of these provisions is overly broad. A fundamental aspect of appropriate CRA regulation is preserving analytical independence by avoiding regulatory mandates affecting criteria and methodologies and not second-guessing rating opinions. We would seek to clarify the meaning and what potential terms, conditions and changes are envisaged to determine the impact on our analytical independence and objectivity. Furthermore, the language used in the Consultation Paper indicates that the power to require a change in practices and procedures could be directed against individual approved credit rating organizations, rather than all of them. This could, in theory at least, mean that each

individual CRA can be ordered by its regulator to follow different practices. Unless there is a clearly demonstrated need to treat individual approved CRAs differently, we submit that this would not be desirable and would not promote a transparent and consistent set of industry-wide standards.

3.6 We therefore believe that any system of regulation should specify, at the outset, the types of procedures and practices that regulated CRAs are required to have in place, allowing flexibility for different business models, types of ratings and also preserving a CRA's independence. Examples of areas of appropriate regulatory focus are conflict of interest policies and personal securities ownership and trading restrictions. We recognise requirements in these areas may have to change over time but believe there should be safeguards in place to ensure that a proper consultation process is followed before imposing such changes and a reasonable compliance effective date is set to allow adequate time to make the necessary changes.

3.7 We would also urge the Committee to develop a mechanism that would ensure consultation and coordination on regulatory oversight and actions among the different CSA members.

Information gathering powers

3.8 We note the proposal states that an approved credit rating organisation would be required to provide securities regulators, on request, with information about its business as a CRA and that this should include "*any other information, documents, books and records related to its credit rating business*". We appreciate that appropriate disclosure to the regulator is needed for effective regulation. We submit however that any such requests should be sensitive to confidentiality and privilege that might otherwise apply.

Disclosure requirements relating to asset-backed securities

3.9 We note that the Committee is considering a disclosure obligation similar to the previously proposed SEC requirements for structured finance products ("June 08 SEC disclosure proposal"[2]). We have already submitted a letter to the SEC setting out at length our concerns over the June 08 SEC disclosure proposal.[3] We do not propose to set out all of those concerns here but highlight the following:

(a) As the Committee has recognised in its Consultation Paper, the new disclosure requirement would put the onus on CRAs, rather than on issuers, to ensure disclosure of information about structured finance products. This would represent in our opinion a radical re-ordering of the roles and responsibilities of the parties involved in a securities offering. In particular, the June 08 SEC disclosure proposal did not provide a safe harbour for a CRA that obtains an undertaking from an arranger to disclose the information in accordance with the rule. The proposal would therefore leave the disclosure burden squarely on the shoulders of the CRA and risk involving the CRA in the "*working group*" for each structured product transaction. It is unclear how else the CRA would know when the transaction was scheduled to price, or close, so that it would be able at a moment's notice to publicise the information, or know who the "*investors*" would be in an unregistered transaction. Very importantly, a CRA may not have access to, or may not know of, all information that might be appropriately disclosed. We also believe that it is unprecedented for this type of affirmative disclosure obligation to be placed on a party that is not an issuer, seller or underwriter.

(b) Similarly, once an offering is completed, the June 08 SEC disclosure proposal would create an ongoing public disclosure obligation for CRAs. This too is unprecedented. We are aware of no other continuous disclosure

[2] http://www.sec.gov/rules/proposed/2008/34-57967.pdf

[3] http://www.sec.gov/comments/s7-13-08/s71308-23.pdf - see page 9 et seq.

requirement upon a party other than an issuer and its security holders to provide information about a security to the market, on an ongoing basis.

(c) The cost implications of the proposed rule would we believe be very significant. Effectively, S&P would have to be in a position to capture and disclose, at a moment's notice, information that may have come to it in a variety of different formats (including electronic, email, paper and voice) and to sort through what information was "*used*" and not "*used*" in formulating a rating. We estimate that it would be very costly to build, test and deploy a system that would allow us to comply with the June 08 SEC disclosure proposal, both on an initial and an ongoing basis.

3.10 We also agree with the Committee's observation that the disclosure requirement would force CRAs to address difficult implementation issues, "*such as privacy concerns arising from the dissemination into the public domain of personal information or confidential business information*". In this context, we should point out that information may be provided to a CRA by an arranger or trustee, but not ultimately used by the CRA in formulating or surveilling a rating. Given the volume of information covered by the proposed requirement, the global scope and breadth of the business that would be affected by it and the strict time limits that would apply for disclosure, it would be extremely burdensome and impractical to require a CRA to sort through the information that has been provided and determine which bits of data were "*used*" and which were not. Therefore, we believe there is a very real risk that confidential information would enter the public domain even if it has not in fact been "*used*" by the CRA for the purposes of determining and monitoring a rating. Additionally, some types of information may simply not be "*used*" by a particular rating agency within its methodology even if it would be viewed as material by some investors or by another rating agency. The significance of different categories within the methodology of a rating agency should not, in our view, determine the necessity of its disclosure to market participants generally. This could also raise the possibility that sponsors would be reluctant to freely share information with rating agencies resulting in limited disclosure and possibly impacting ratings quality.

3.11 A further concern with this proposal is the risk that CRAs are viewed as a primary vehicle for disclosure about an issuer. This is not the role of rating agencies and investors should not look to CRAs for more than independent opinions on credit quality. This proposal may also create a barrier to entry to other credit rating agencies to the extent one CRA becomes established as the preferred provider of disclosure management.

3.12 For these reasons, we are concerned that a rule of the type being considered would be ill-advised and unworkable.

3.13 We further note on this issue the recent SEC actions on February 2, 2009 which include, among other things, a reproposal of the June 08 SEC disclosure proposal.[4] Of particular note is the fact that the SEC no longer proposes that the onus for disclosure of information regarding structured finance products be placed on CRAs. We are reviewing the details of the SEC's reproposed rule and will submit comments by the deadline. We will also share our comments with the Committee.

Analytical independence

3.14 We are pleased to note that in its introductory comments in Part 2, the Committee states that regulators should not be in the business of regulating or second-guessing methodologies and assumptions that are used in the credit rating process. In our view, preservation of CRAs' analytical independence is a fundamental principle upon which any system of regulation should be built. We therefore believe that, consistent with the US approach[5], there should be an express provision within any CRA framework that states that the regulators will not interfere with credit ratings or

[4] http://www.sec.gov/rules/proposed/2009/34-59343.pdf

[5] http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s3850enr.txt.pdf

methodologies. Similarly, we would submit that any power that regulators are given to direct CRAs to take specific actions or to adopt particular practices must also be limited by this principle.

Accountability of CRAs

3.15 Any new CRA framework could hold CRAs accountable for established breaches of the regulations, but without undermining analytical independence. We believe, however, that it is important for the rules to clearly state that breaches of the regulatory provisions will not give rise to any private causes of actions. This solution would be consistent with the approach that has already been taken in the United States.[6]

4. **CSA proposal #3:**

The Committee proposes a separate policy review to consider the appropriateness of

(i) *the income and net financial assets thresholds in the accredited investor definition, and*

(ii) *$150,000 exemption.*

4.1 In section 3(g) of the Consultation Paper, the Committee discusses the disclosure requirement for asset-backed short-term debt, and concludes that it is satisfied that the absence of a requirement of a prospectus for distributions of such debt can be justified. The Committee states that it has considered the following matter in arriving at this decision:-

> *"The transparency of asset-backed securities would be significantly enhanced if a disclosure obligation is adopted as part of the CRA Framework by requiring disclosure of all information by a CRA in determining and monitoring a rating for an asset-backed security."*

4.2 In this regard, we repeat the observations that we have made in paragraphs 3.9 through 3.13 above about the possible requirement for disclosure of all information used by a CRA.

4.3 If the level of information and transparency available to potential purchasers of asset-backed securities is to be improved then we believe that the use of prospectuses would be the most effective means. This requirement would in our view provide that the issuer (rather than a CRA) is the party that is under an obligation to provide proper transparency to the market, and we submit that is exactly where that obligation should lie. Furthermore, a requirement for a prospectus disclosing material facts and information about an issue would be much more effective in providing investors with useful information than a requirement for CRAs to disclose all the information that they use. The specific function of a prospectus is to provide information to investors in a format that is designed to promote accuracy and clarity. Although we understand the need for introducing requirements that would bring greater transparency, we believe it would be inappropriate to exempt issuers from those requirements on the basis that they will instead be imposed on CRAs.

4.4 At a broader level, we also comment on the Committee's observation that the rationale for not requiring a prospectus under the short-term debt exemption is that "*the security is considered of sufficiently high credit quality by virtue of its short term to maturity and its credit rating*". In our view, investors should have the benefit of utmost transparency and should not use credit ratings alone. Although we believe that ratings can be a useful tool to investors, there are limitations as to their purpose and use. Consistent with our communications to the market over the years, ratings are statements of opinion and not statements of fact or recommendations to buy, sell or hold any securities or make other

[6] Section 4 of the Credit Rating Agency Reform Act of 2006 states that nothing in that legislation "*may be construed as creating any private right of action*".

investment decisions.[7] Ratings are not a measure of asset value nor are they intended to signal the suitability of an investment. They speak to one aspect of an investment decision – credit quality. We therefore are of the firm view, shared by many market participants and regulators, that a credit rating is not a substitute for prospectus disclosure. To suggest otherwise may incentivise investors to use ratings in a manner for which they were not designed and, we believe, would be contrary to the view that investors should take responsibility for understanding their investments and the nature of ratings. Investors should be encouraged to conduct their own due diligence on the particular risks associated with each security and to assess whether the price of those securities – which our rating does not address - properly reflects those risks when weighed against the expected return. We do not therefore agree with the proposition that a prospectus becomes redundant where the security has a credit rating. For further information regarding the meaning of S&P credit ratings we direct the Committee to our "Guide to Credit Rating Essentials"[8].

4.5 Our discussion in section 5 below of the reliance on credit ratings in Canadian securities legislation is also relevant in this context.

5. CSA proposal #4

The Committee is considering whether to reduce the reliance on credit ratings in Canadian securities regulation.

5.1 Proposals similar to CSA proposal #4 were made by the SEC last year. In our comment letter to the SEC regarding this issue[9], we commented as follows:

> "Ratings Services began its credit rating activities more than ninety years ago, in 1916, many decades before NRSRO recognition was established. Since that time, Ratings Services' credit ratings have provided an independent and effective tool for the market's evaluation and assessment of credit risk. By virtually all accounts, our ratings – both before and after we were recognized as an NRSRO – have served as valuable independent opinions in the U.S. debt market. More than any regulatory framework or NRSRO recognition, the market's recognition of our independent opinions and our commitment to analytical excellence have been the primary drivers of our success over these ninety-plus years.
>
> Ratings Services believes that because the Commission's rules and forms have been in place for many years and market participants are accustomed to working with them, the views and insights of market participants should be carefully factored into the Commission's deliberation process as it moves towards final rulemaking. We therefore encourage the Commission to pay close attention to the comments offered by market participants who will be most directly impacted by the proposed amendments, and we trust that the Commission will be particularly alert to any concern raised by these market participants that, should any changes be made, they be implemented in an orderly manner to avoid any market disruption."

We believe that these comments are also relevant to the Committee's consideration of CSA proposal #4.

5.2 In considering this proposal we believe that the Committee should also consider whether ratings tests as currently found in regulation, may deter sponsors from obtaining multiple ratings opinions and create unintended incentives for sponsors to seek the highest singular ratings possible. We believe that the recent history of the Canadian ABCP sector

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[7] IOSCO's May 2008 Report on "The Role of Credit Rating Agencies in Structured Finance Markets": "While some observers and market participants believe that a CRA rating represents a judgment on the worthiness of an investment…,the OPINIONS (emphasis added) of CRAs relate solely to the likelihood that a given debt security will perform according to its terms. As described in previous IOSCO reports, a high credit rating does not necessarily indicate that a security is a good investment, nor does a low credit rating necessarily make the security a poor investment."

[8] .http://www2.standardandpoors.com/spf/pdf/fixedincome/SP_CreditRatingsGuide.pdf

[9] http://www.sec.gov/comments/s7-19-08/s71908-46.pdf

demonstrates some of the implications of divergent rating opinions in relation to the issue of ratings references found in regulation.

5.3 Since ratings are independently-formed opinions, it is not at all uncommon for rating agencies to have divergent rating opinions. Differences in ratings can arise from differences in rating definitions, differences in analytical criteria, differences in relative scope and depth of analysis underlying different ratings, and differences in sector- and issuer-specific analytical judgments. We believe as a general matter that the market is well served by having multiple rating opinions available.

6. Conclusion

6.1 S&P appreciates the opportunity to comment on the proposals issued by the CSA in the Consultation Paper and looks forward to the Committee's further views and comments on the subject matter as they develop. We look forward to continuing our dialogue with CSA members on these proposals and our views.

Respectfully,

Executive Vice President
Ratings Services