MOODY'S
INVESTORS SERVICE

August 31, 2011

By Electronic Mail

To: Members of the Canadian Securities Administrators ("CSA")

Re: Proposed NI 41-103 - Supplementary Prospectus Disclosure Requirements for Securitized Products; Proposed NI 51-106 - Continuous Disclosure Requirements for Securitized Products; Proposed Amendments to NI 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings; Proposed Amendments to NI 45-106 - Prospectus and Registration Exemptions; Proposed Amendments to NI 45-102 - Resale of Securities; and Proposed Consequential Amendments (together, the "Proposed Rules")

I. Introduction

Moody's Investor Services ("**MIS**") appreciates the opportunity to comment on the Proposed Rules. MIS generally supports the CSA's proposal to require issuers to provide enhanced disclosure for securitized products. MIS believes that many of the changes along the lines proposed by the CSA could help reduce the risk of investor over-reliance on credit ratings and of issuers engaging in rating shopping. We have some concerns, however, about the CSA's proposed disclosure requirements relating to credit ratings. We are not opposed to disclosure of credit ratings *per se*. MIS and a number of other credit rating agencies ("**CRAs**") make their credit ratings and the rationale for those ratings publicly available for free. Rather, we believe that requiring issuers to disclose information about credit ratings in offering documents and continuous disclosure documents places too much emphasis on credit ratings and weakens incentives for investors to conduct their own analysis. We also believe that the proposed requirements that issuers disclose preliminary credit ratings and instances where a CRA has refused to rate one or more classes of the securitized products are not effective measures to reduce rating shopping.

We also address the CSA's request for feedback on whether it should replace ratings-based shelf and short-form prospectus eligibility criteria with alternative measures. We appreciate the CSA's efforts to promote dialogue on this subject. Historically, MIS has supported efforts to discontinue the mechanistic use of credit ratings in regulation. We believe that the ratings-based shelf and short-form eligibility criteria for securitized products could be replaced with alternative criteria without significant disruption to Canadian structured finance markets.

Below, we set out a more detailed discussion of these issues.

II. Proposed Disclosure Requirements for Securitized Products

A. MIS Generally Supports Enhanced Issuer Disclosure Requirements for Securitized Products

Analyzing and monitoring securitized products is a data-intensive process. Consequently, MIS believes that one of the most significant steps that can be taken to restore confidence in the structured finance market and promote the appropriate use of credit ratings is to improve the availability and quantity of underlying information. Therefore, we support the CSA's efforts to enhance the initial and ongoing disclosure regimes for issuers of securitized products.

Unlike in the corporate market, where investors and other market participants can reasonably develop their own informed opinions based on publicly available information, currently there is less publicly available information in the structured finance market. Consequently, CRAs, for example, typically ask for additional, non-public information from issuers to analyze and rate such securities.

If there is insufficient, publicly available data, investors are unable to conduct their own, comprehensive analysis and develop fully informed views of their own about potential or existing investments. This creates an environment in which investors may be motivated to over-emphasize credit ratings and/or use them for purposes other than as opinions about relative credit risk. In addition, issuers, sponsors and underwriters (collectively, "**Arrangers**") may believe that because of the limited information available in the market they can shop for a CRA on the basis of factors other than ratings quality and credibility.

To address these problems in the structured finance market, MIS has been recommending for some time that policymakers consider requiring issuers of securitized products to disclose all of the information needed by investors to conduct a thorough analysis of the principal risks of the securities they are considering for purchase, holding or sale. Therefore, we generally support the CSA's proposals to require enhanced disclosure in all prospectuses used to distribute securitized products and mandate a form of offering memorandum for prospectus-exempt distributions of short-term securitized products. MIS also would support mandated disclosure, along the same lines, to prospective investors for prospectus-exempt distributions of securitized products that are not short-term. MIS also generally supports the proposed continuous disclosure requirements for issuers of securitized products.[1]

Although we generally support the CSA's proposals to enhance the disclosure regime for issuers of securitized products, we have refrained from making comments on the specific proposals regarding disclosure in both prospectus and prospectus-exempt distributions of securitized products. This is because we believe that investors are in the best position to inform the CSA about which types of information they believe they would find material to their investment decision and how much time they need to evaluate that information.

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[1] As discussed in Subsections II(B) and (C) below, however, we do not support provisions requiring issuers to disclose credit ratings, changes in credit ratings, CRAs' analysis of market risks that would affect credit ratings, factors or considerations identified by the CRA as giving rise to unusual risks associated with the securities, preliminary credit ratings or instances where one or more CRAs have refused to rate any of the offered securitized products.

B. Requiring Issuers to Disclose Information about Ratings Is Inconsistent with Efforts to Discourage Over-reliance on Ratings

While MIS generally supports the enhanced disclosure requirements in the Proposed Rules, we believe that issuers should not be required to disclose information regarding ratings in offering documents such as prospectuses or continuous disclosure reports.[2] Historically, MIS has supported discontinuing or limiting the use of credit ratings in regulation, including mandatory ratings disclosure requirements for issuers, because we believe that such requirements can contribute to over-reliance on ratings.[3] Consequently, we are concerned that the disclosure proposals could perpetuate and exacerbate incentives for market participants to over-rely on ratings.

CRAs occupy a narrow niche in the information industry. We provide forward-looking opinions and research about relative credit risk for use by institutional investors. Our ratings, together with the associated rating rationale, provide a point of reference that we believe is easily understood by these market professionals. We intend for our ratings to promote dialogue and debate among these market professionals, who we expect to assess our opinions relative to their own credit judgments.

The fact that an issuer obtains a credit rating or discloses it in the context of an offering does not mean that the rating, standing alone, is material to an investment decision. A distinction should be drawn between risk factors (*e.g.*, credit risk), which should be disclosed by the issuer if material, and certain market commentators' opinions about that risk (such as credit ratings). A rating may convey (in an investor's opinion) useful information, just as an equity analyst's report or a newspaper article about the issuer might, but this does not mean that an issuer should have to disclose such third-party commentary in a prospectus or otherwise.

Similarly, MIS believes that the CSA should not deem changes in credit ratings as "significant events" that always require timely disclosure in a material change report. In MIS's view, the events that lead to a change in credit rating may be significant events or material changes. A change in a credit rating, however, is a change in one market commentator's opinion, and that opinion is limited to an assessment of the relative creditworthiness of the rated securities or the issuer. That change in opinion may have consequences for the issuer or its securities and those potential consequences may be significant contingencies that should be disclosed. We do not believe, however, that all changes in credit ratings are significant or material events in themselves, and we believe that it should be the issuer's responsibility to assess the totality of its circumstances

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2 See, *e.g.*: (1) item 10 of *Form 41-103F1 – Supplementary Prospectus Disclosure Requirements for Securitized Products*; (2) items 1.2 and 12 of *Form 45-106F7 - Information Memorandum for Short-Term Securitized Products*; (iii)) items 2 and 5 of *Form 45-106F8 – Periodic Disclosure Report for Short-Term Securitized Products Distributed under an Exemption from the Prospectus Requirements*; and (iv) section 5 of *Proposed National Instrument 51-106 – Continuous Disclosure Requirements for Securitized Products*.

3 See, *e.g.*, MIS Comment Letter on Proposed National Instrument NI 25-101 – Designated Rating Organizations (Nov. 2010); MIS Comment Letter on U.S. Securities and Exchange Commission's Proposed Rules on Credit Ratings Disclosure (Dec. 2009); and MIS Submission to the IOSCO Task Force on Unregulated Markets and Products (June 2009).

and come to a decision about whether or not the rating change or the potential consequences of the rating change should be disclosed .[4]

Moreover, we believe that labeling changes in credit ratings as "significant events" and requiring issuers to disclose such changes is likely to encourage market participants to over-emphasize credit ratings. As a result, the incentives for investors to conduct their own credit analysis and for issuers to conduct a comprehensive assessment of the implications of their changed circumstances and, if appropriate, disclose their conclusion, will be weakened. We believe this outcome is inconsistent with the efforts of regulators to reduce the risk of over-reliance on ratings. We believe that the more appropriate solution would be for the CSA to refrain from including changes in credit ratings in the list of significant events that must be disclosed on a timely basis.

We note that in 2010, the Financial Stability Board endorsed principles ("**FSB Principles**") [5] to reduce reliance on credit ratings. Among other things, the FSB Principles call upon authorities to review whether ratings disclosure requirements provide unintended incentives for investors to rely excessively on ratings and, if appropriate, to remove or amend these requirements. MIS believes that the ratings disclosure requirements in the Proposed Rules are inconsistent with the FSB Principles and other authorities' efforts globally to reduce the risk of over-reliance on ratings.[6] We also believe that requiring issuers to disclose ratings draws attention away from other, generally more important information that will be required to be disclosed by the Proposed Rules. We are especially concerned that mandatory ratings disclosure requirements may encourage many retail investors, who often are less sophisticated than institutional investors, to erroneously view the credit rating as their "one-stop shop" for information that is material to their investment decision. Disclosures by the issuer about the limitations of credit ratings are likely to be insufficient to discourage investors from over-emphasizing them.

We recognize that it might seem counter-intuitive to advocate against mandatory disclosure of credit ratings, which some market participants find useful. Some might argue that the fairness and efficiency of capital markets depend on transparency, and therefore more disclosure is always better. MIS supports efforts to provide investors with the full spectrum of information that investors might consider useful to their investment decision. These efforts include the CSA's Proposed Rules, continued dissemination of credit rating information through the internet, implementation by CRAs of the IOSCO Code's transparency recommendations and disclosure by issuers of any known trends, demands, commitments, events or uncertainties that may affect their liquidity or results of operations.

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4 Similarly, we believe that issuers of short-term securitized products should be responsible for assessing whether an announcement or proposed announcement by a CRA that it is reviewing or intends to revise or withdraw a previously assigned credit rating should be disclosed in periodic disclosure reports. We recommend, therefore, that proposed Item 12(d) of Form 45-1067F be deleted.

5 See FSB, Principle III.5.a in *Principles for Reducing Reliance on CRA Ratings* (October, 2010), available at www.financialstabilityboard.org/publications/r_101027.pdf

6 For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act calls for U.S. federal agencies to reconsider their use of ratings in regulation. In Brazil, financial market regulators have conducted a study of how ratings are used in regulation and are considering options to eliminate or modify some of these provisions.

Our objection, therefore, is not with disclosure of ratings *per se*. Our objection is to mandated disclosure of ratings *by issuers*, because such a requirement itself may cause investors to place too much weight on credit ratings or use them inappropriately. Given that credit ratings are widely and publicly available, we believe that the adverse consequences of mandating disclosure of ratings by issuers outweigh the potential advantages.

Consequently, we recommend that the CSA: (i) should not require issuers or other non-CRA market participants to disclose credit ratings, or changes in ratings, in the Proposed Rules and (ii) should repeal any similar requirements in Canadian securities laws. We would not object, however, to a rule stating that, if an issuer elects to disclose a credit rating in a prospectus or continuous disclosure document, the issuer also should disclose:

- the name of the CRA that assigned the rating and whether or not it is a designated rating organization;
- the credit rating assigned;
- the CRA's website address where an interested person can obtain a description of the CRA's rating system, the credit rating, the CRA's rationale for the rating and ratings performance information; and
- a statement that the rating is not a recommendation to buy, sell or hold securities and may be subject to revision at any time by the CRA.

MIS also is strongly opposed to proposed Item 10(d) of Form 41-103F1, which would require reporting issuers to disclose in a prospectus the analysis of a CRA as to market risks that may have an impact on the credit rating and the nature of the market risk that the CRA has identified. We have similar concerns about proposed Item 12(c) of Form 45-106F7, which would require an issuer to disclose in an offering memorandum for rated short-term securitized products any factors or considerations identified by the CRA as giving rise to unusual risks associated with the series. We believe that issuers should not be required to provide explanatory narratives for opinions that are not their own. Similarly, we believe that issuers should not be required to disclose the CRA's definition or description of the rating category to which the assigned rating belongs. Issuers that attempt to provide the disclosures called for in proposed Item 10(d) and the second part of Item 10(e) of Form 41-103F1 and Item 12(c) of Form 45-1067F risk presenting the information inaccurately or out of context. Alternatively, they may ask the CRA to draft or review draft disclosures for the prospectus, a function that is inconsistent with the limited role of CRAs in the market and that could create the mistaken impression that CRAs are participants in the offering, rather than independent commentators. MIS also believes that the proposed disclosure requirements are unnecessary because this type of information is available on the CRA's website, where it can be appropriately contextualized. Accordingly, we recommend that proposed Item 10(d) and the second part of Item 10(e) be deleted from proposed Form 41-103F1. Similarly, proposed Item 12(c) of Form 45-106F7 should be deleted.

C. Measures to Discourage Rating Shopping

MIS supports the CSA's efforts to address rating shopping.[7] We believe, however, that the proposed requirements that issuers disclose in the prospectus preliminary credit ratings and whether any CRA has refused to assign a credit rating to a class of securitized products being distributed, will not address effectively the rating shopping problem or provide meaningful disclosure to the market.[8]

We are concerned that these requirements might simply move rating shopping to an earlier point in the rating process. For example, instead of seeking preliminary ratings from a number of CRAs and then selecting one or more ratings to use in connection with the offering, issuers will be more likely to avoid approaching CRAs that are known to have more conservative methodologies. (This practice already occurs but the new disclosure requirement would reinforce the incentives to do so.) Issuers also will be less likely to engage in initial conversations with smaller or newer CRAs, or CRAs that are starting to build up a new practice area, because the issuer is less likely to be familiar with such CRAs' methodologies and rating procedures. This could adversely affect competition based on ratings quality in the CRA industry, *e.g.*, by making it harder for CRAs to enter the market or expand their scope of coverage and/or making it harder for more conservative CRAs to compete for business. Alternatively, issuers could simply present "hypotheticals" to CRAs and claim that they did not submit a securitized product for initial review. Implementation of this requirement also could leave market participants with the mistaken impression that no rating shopping has occurred.

For these reasons, we recommend that these disclosure items be deleted from Form 41-103F. In our view, the most effective way to address rating shopping is to enhance the mandatory disclosure regime for structured finance products. Greater transparency in this market would make it more difficult for issuers to shop for ratings because CRAs and other market observers will have access to the information needed to publish their own opinions. Similarly, investors will have access to greater information to assess the structured finance products and the quality of the opinions that CRAs and other market observers make available.

III. Ratings-Based Shelf and Short-Form Eligibility Criteria for Issuers of Securitized Products Should Be Repealed

The CSA has requested feedback on whether to replace the existing credit ratings-based shelf and short-form eligibility criteria for securitized products with alternative criteria. MIS supports the CSA's efforts to promote discussion and reconsideration of the regulatory use of credit ratings. As noted in the Introduction, historically we have supported efforts to discontinue the mechanistic use

7 See also MIS's Comment Letter on Re-proposed NI 25-101 – Designated Rating Organizations (May 2011).

8 Proposed item 10(f) of Form 41-103F1 would require the issuer to disclose any preliminary credit rating obtained by a sponsor or arranger for any class of the securitized products being distributed. Proposed item 10(g) would require the issuer to disclose any preliminary credit rating obtained by a sponsor or arranger for any class of the securitized products being distributed and the reasons for refusal if it is related to the structure or the financial viability of the securitized product transaction.

of credit ratings in regulation.[9] We believe that ratings-based criteria, such as the shelf and short-form eligibility criteria for securitized products, can weaken the incentives for investors to conduct their own credit analyses and strengthen the incentives for issuers to select CRAs based on factors other than ratings quality.

Consequently, we would support the replacement of the ratings-based shelf and short-form prospectus eligibility criteria with alternative criteria. For the same reasons, we believe that the proposed definition of "short-term debt" in *NI 45-106 – Prospectus and Registration Exemptions* should not include ratings-based eligibility criteria. Likewise, if the CSA decides to introduce a prospectus exemption for asset-backed commercial paper, we would be opposed to the use of ratings-based eligibility criteria. We have refrained, however, from commenting on alternative eligibility criteria because we believe that other market participants, such as investors and issuers, as well as the CSA itself, are in a better position to judge which alternative criteria are appropriate to meet the CSA's objectives.

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Once again, we appreciate the opportunity to comment on the Proposed Rules. We would be pleased to discuss our comments further with CSA members.

Sincerely,

Donald S. Carter	Janet Holmes
Managing Director	Senior Vice President
Moody's Canada Inc.	Head of Americas Regulatory Affairs
	Moody's

[9] See, *e.g.*, MIS's Response to the CSA Consultation Paper 11-405 (Feb. 2009); Comment Letter re Joint Notice of Proposed Rulemaking on Alternatives to the Use of Credit Ratings in the Risk-Based Capital Guidelines of the Federal Banking Agencies (Oct. 2010); Comment Letter re Proposed Amendments to Regulation AB (Aug. 2010); Comment Letter re Credit Ratings Disclosure (Dec. 2009); and Comment Letter re References to Ratings of Nationally Recognized Statistical Rating Organizations (Sept. 5, 2008).