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To: British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marches financiers, Québec
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Re: Proposed Amendments to National Instrument 45-106 Prospectus and Registration Exemptions Relating to the Short-term Debt Prospectus Exemption and Proposed Securitized Products Amendments ("Proposal")

Moody's Investors Service ("MIS") appreciates the opportunity to provide comments to the Canadian Securities Administrators ("CSA") on the Proposal.

MIS supports efforts to enhance issuer disclosure for securitized products. However, MIS is concerned that some parts of the Proposal may be inconsistent with 1) the broader public policy objective of reducing mechanistic use of ratings in regulation[1], 2) the role that credit rating agencies ("CRAs") play in the capital markets[2] and 3) the effect that such reliance and mischaracterization has on how credit ratings are treated. We discuss these concerns in more detail below and in the Annex to this letter.

[1] See Annex 1: Section 2.35 (b&c) of the Proposals.
[2] See Annex 1: Section 8.2 (f) and 8.3 (c) of the Proposals.

1) Mechanistic use of ratings in regulation

MIS's credit ratings are our current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. They do not measure any other risk, and should not be used as a proxy for assessing other characteristics of a security, such as liquidity risk, price volatility or marketability. We are concerned that the Proposal includes provisions that leverage credit ratings as a mechanistic trigger[3] or hurdle[4]. We believe that mechanistic use of credit ratings can harm markets inadvertently by amplifying, rather than diminishing, risks in the financial system. Specifically, automatic triggers in regulation can cause involuntary and mandatory reactions with little room for regulated market participants or authorities to consider more nuanced and context-specific responses.

In its *Principles to Reduce Reliance on Credit Ratings*,[5] the Financial Stability Board ("FSB") states that:

> *Standard setters and authorities should assess references to credit rating agency (CRA) ratings in standards, laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness.*[6]

Consistent with these FSB principles, therefore, we recommend that the CSA revise the proposed rules to eliminate ratings-based eligibility criteria.

2) Inconsistent with CRAs' Role in the Capital Markets

MIS supports efforts to provide the market with the full spectrum of information that investors might consider useful to their investment decision and believe securities regulators are best placed to determine the disclosure requirements in their jurisdictions. The requirement in the Securitization Transaction Report in Form 45-106F8, requiring the disclosure of each credit rating in respect of each originator of assets, could however, lead investors to think that CRAs are participants in the distribution of securities. As a regulatory requirement, this disclosure may over-emphasize the rating's significance and draw attention away from other, generally more important information.

Such disclosure is also inconsistent with a CRAs intended and expected role as an impartial and independent commentator on credit risk and would not be in line with the intention of regulators around the globe to reduce any over-reliance on credit ratings. MIS remains concerned that this rule would inappropriately create an impression that the availability of CRA opinions could be a substitute for transparency in the structured finance market.

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[3] Such as forcing asset sales when a particular rating threshold is no longer met.

[4] Such as the proposed prospectus exemption, the sole eligibility criteria of which is based on a rating (and it meeting a particular threshold).

[5] (October 2010), available at http://www.financialstabilityboard.org/publications/r_101027.pdf.

[6] Principle 1 of FSB Principles.

3) Commoditization of credit ratings

MIS believes that widespread incorporation of ratings into regulation can encourage regulated entities to treat ratings from recognized CRAs as interchangeable for regulatory purposes. Ratings, therefore, tend to become commoditized, which can affect the traditional incentives to differentiate among CRAs based on the ratings' credibility. In other words, the incentive for entities to conduct their own credit analysis and use ratings as just one of several inputs in their decision-making process is weakened if the regulatory framework permits them to use an officially recognized rating without ongoing consideration of whether the rating conveys the information they need and is of sufficient quality. Ratings-based eligibility criteria also creates incentives for issuers to shop for ratings based on factors other than the quality of and credibility of the ratings.

Once again, we thank you for the opportunity to comment on the Proposal. We remain available for any questions you may have regarding this submission or more broadly on the role of CRAs in the capital markets.

Regards,

Annex – Responses to Questions in the Request for Comment

Below please find answers to those questions where we believe MIS has relevant insight for the CSA's consideration.

Proposed Short-Term Debt Amendments

Questions

1. **We are proposing a Modified Split Rating Condition as part of the Proposed Short-Term Debt Amendments in order to maintain minimum credit quality standards for CP that is issued through the Short-Term Debt Prospectus Exemption. Do you agree that some type of Split Rating Condition is necessary to achieve this objective, and if so, is the Modified Split Rating Condition we propose appropriate?**

   As mentioned in section 1 of our letter, MIS recommends against the use of any ratings as a condition of regulatory eligibility or as a triggering mechanism. As per our reference to the FSB Principles in our letter, we believe that including credit ratings as a regulatory requirement increases the risk of investors over-relying on credit ratings or using them for purposes for which they are not intended.

2. **Is the Rating Threshold Condition in the Proposed Short-Term Debt Amendments appropriate? Should the Short-Term Debt Prospectus Exemption have a higher or lower rating threshold? If a lower threshold were adopted, would it raise investor protection concerns that lower-rated CP would be sold to less sophisticated or knowledgeable investors? If so, how could these concerns be addressed?**

   Consistent with our comment above, MIS discourages the regulatory use of eligibility thresholds tied to credit rating levels. As mentioned in section 3 of our letter, by requiring an issuer to obtain a credit rating at or above a particular threshold, regulation can unintentionally encourage rating shopping and discourage issuers from selecting CRAs based on ratings quality and discourage market participants from independently assessing credit risk.

3. **The Short-Term Debt Prospectus Exemption's primary condition relates to credit ratings. Do credit ratings in this context serve appropriate investor protection and market efficiency functions? Are there alternative or additional conditions that would materially enhance investor protection or financial stability?**

   In addition to the arguments we set out in our letter regarding the use of and over-reliance on ratings, the appropriation of ratings for regulatory purposes also risks legislative or regulatory intrusion into the content of ratings, as authorities' interest in

comparable ratings can pressure CRAs to produce a homogenous product and undermine their ability to provide diverse, independent opinions. Investor protection and financial stability would be enhanced where the regulator uses a comprehensive disclosure regime and does not allow investors to over rely on one function within the market.

4. **Should the Short-Term Debt Prospectus Exemption be unavailable if: (a) a DRO has announced that a credit rating it has issued for the CP is under review and may be downgraded; and(b) that downgrade would result in the CP no longer satisfying both the Rating Threshold Condition and the Modified Split Rating Condition?**

A credit rating action should not have the effect of a triggering mechanism in regard to regulatory eligibility (such as an exemption to provide a prospectus). As we indicated in our response to question 2 and as more fully set out in section 3 of our letter, ratings-based eligibility criteria can unintentionally encourage rating shopping and discourage individual assessments of credit risk.

Proposed Securitized Products Amendments

Questions

2. **Are the credit rating requirements (two credit ratings at a prescribed minimum level) for short-term securitized products sold under the Short-Term Securitized Products Prospectus Exemption appropriate?**

In addition to the arguments we set out in our letter regarding the use of and over-reliance on ratings MIS would also be concerned that this rule would inappropriately create an impression that the requirement for, and availability of credit ratings could be a substitute for transparency in the structured finance market.

3. **We have prescribed a number of liquidity support requirements to address liquidity risk arising from the maturity mismatch in ABCP.**

   (a) **The Bank of Canada's eligibility policies for collateral under its Standing Liquidity Facility require that sponsors of ABCP conduits have certain credit ratings, as opposed to the liquidity provider. Should there also be requirements in the Short-Term Securitized Products Prospectus Exemption as to the types of entities that can sponsor ABCP conduits (including credit ratings of those entities)?**

   (b) **How common is it for a sponsor to not also be the liquidity provider?**

(c) **In order to reduce the risk associated with relying on a single credit rating of one DRO, we are proposing that two credit ratings be required for the liquidity provider. Do you agree with this approach?**

(d) **Are the proposed minimum credit rating levels for the liquidity provider appropriate?**

These requirements would create mechanistic hurdles (eligibility criteria) and triggering mechanisms (such as the inability of a liquidity provider to continue its service when it no longer meets the rating threshold). This use of ratings would be inconsistent with the role of a CRA in the capital market and may lead to unintended consequences as per sections 2 and 3 of our letter.