

SUBMISSION - CREDIT RATING SERVICES BILL [BILL 8 OF 2012]

TO: Honourable T. Mufamadi
MP and Chairman: Standing Committee on Finance
Parliament of South Africa
By email: awicomb@parliament.gov.za
Copied to: Mr Roy Haveman, National Treasury
Mr Roland Cooper, Financial Services Board

FROM: Ms Adri Messerschmidt
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1. BACKGROUND ON ASISA

ASISA was formed in October 2008. Incorporated under Section 21, it represents the majority of South Africa's investment managers, collective investment scheme management companies, linked investment service providers, multi-managers, and life insurance companies. ASISA is mandated by its members to pro-actively engage with the policymaker and regulator, as well as intermediaries and consumers on policy, regulatory and other important issues of common concern.

ASISA's strategic purpose and mandate are therefore to remain a trusted partner to stakeholders in the financial services industry and to proactively engage with them on policy, regulatory and other important issues of common concern. ASISA aims to be an active participant in creating an environment that promotes equal opportunities for its members through holistic legislation, while at the same time considering the interests of consumers/investors.

2. SUPPORT OF THE BILL

ASISA collated comments from its members and discussed and considered these comments with nominated member representatives in order to finalise a submission to Parliament. ASISA members manage investments on behalf of clients and thus considered the Bill from an investor's perspective. Investors have limited control over the choice of credit rating agencies and the effect it may have on its investments and therefore supports the objects of the Bill

Even though reliance on credit ratings in legislation is being reduced e.g. in the case of collective investment schemes, ASISA members continue to contract with clients (investors) in respect of exposure limits to credit rating bands. The credit exposure an investor is willing to accept in a portfolio is contractually agreed between the investor and the investment manager. Investors take comfort in an independent evaluation of credit exposure in their portfolios of assets and therefore generally require that investments are rated by credit rating agencies.

Most larger investment management companies employ expert resources to manage credit risk exposures. Such companies will have processes and procedures in place similar to those



applied by credit rating agencies. Smaller companies may not have access to these resources and may rely more heavily on credit ratings issued by credit rating agencies.

The credit rating is related to the setting of the price of an instrument. A credit issue is generally priced at a premium to the risk free rate (the rate at which a government instrument is issued). A higher credit rating translates to a lower interest rate differential. The issuer benefits because it pays less for borrowing. From an investor's perspective, the higher the rating, the lower the perceived risk.

If a credit rating is for example downgraded, it could result in forced selling which may cause large losses to the detriment of investors. The credit rating process must therefore be sound to avoid the risk of an inappropriate downgrading.

It is thus imperative that credit rating agencies are responsible and accountable and that the integrity, transparency and reliability of the credit rating process and credit ratings are protected.

3. COMMENTS

3.1 Definition of "credit rating"

Clause 1 of the Bill

"credit rating" means an opinion regarding the creditworthiness of—

- (a) an entity;*
- (b) a security or a financial instrument; or*
- (c) an issuer of a security or a financial instrument, using an established and defined ranking system of rating categories, excluding any recommendation to purchase, sell or hold any security or financial instrument."*

Recommendation

The words from "using an established..." should drop down as it should be applicable to paragraphs (a), (b) and (c) of the definition.

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3.2 Use of credit ratings

Clause 4 of the Bill

"A regulated person must for regulatory purposes only use credit ratings that are issued or endorsed by credit rating agencies which are registered in accordance with this Act."

Comment

The wording of this clause may be misinterpreted to mean that a regulated person must use credit ratings issued by registered credit rating agencies and may not use any other ratings for example an internal rating. ASISA members understand that this was not the intention as National Treasury indicated in its documented response to

comments on the first draft of the Bill that the regulatory obligations on regulated persons (e.g. an insurance company) reside in the primary (and subordinate) legislation applicable to such regulated persons. The clause is intended to require that when the services of a credit rating agency are utilised for regulatory purposes, the credit rating agency must be registered as envisaged by the Bill.

ASISA members remain of the opinion that this provision should not be included in the Bill given that the regulatory obligations in respect of regulated persons reside in the primary (and subordinate) legislation. The provision is likely to be misinterpreted.

If National Treasury and Parliament wish to retain this provision, ASISA members suggest the following wording for the sake of clarity and to limit misinterpretation:

“Where a regulated person use published credit ratings for regulatory purposes, such a regulated person must only use credit ratings that are issued or endorsed by credit rating agencies which are registered in accordance with this Act.”

3.3 Independent compliance unit

Clause 16(1) of the Bill

“A credit rating agency or the group to which the credit rating agency belongs to, must establish and maintain a permanent, independent and effective compliance unit approved by the registrar.”

Comment

ASISA members are of the opinion that the Bill does not adequately enable the application for approval of a compliance unit by the registrar. Section 23(1)(d) provides that the registrar may impose conditions in respect of an approval granted but it does not provide for an application framework including the basis on which such approval will be granted. Clause 16 of the Bill focuses on the functions of a compliance unit. To improve legal certainty, it is suggested that provisions be included to clearly indicate an application process for approval of an independent compliance unit and the basis on which the registrar will grant such approval.

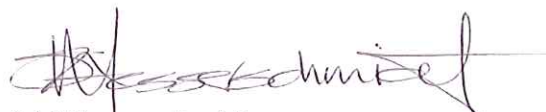
4. APPEARANCE BEFORE THE COMMITTEE

ASISA will appreciate the opportunity to appear before the Committee.

ASISA and its members thank you for the opportunity to submit comments on the Bill.

Handwritten signature of Peter Dempsey in black ink.

Peter Dempsey
Deputy CEO

Handwritten signature of Adri Messerschmidt in black ink.

Adri Messerschmidt
Senior Policy Advisor