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9 May 2012

Mr Thabadiawa Alfred Mufamadi
Chairperson
Standing Committee on Finance

Per E-mail: awicomb@parliament.gov.za

Dear Mr Mufamadi

CREDIT RATING SERVICES BILL ("BILL")

Moody's Investors Service ("MIS") has operated in the Republic of South Africa ("South Africa") through Moody's Investors Service South Africa (Pty) Limited ("MIS SA") for over 8 years. MIS assigns credit ratings on debt covering countries, corporate issuers, public finance issuers and structured finance obligations. MIS recognises South Africa's commitment to introducing a regulatory framework for credit rating agencies ("CRAs") and welcomes the efforts of National Treasury and the Financial Services Board ("FSB") in this regard. The extent of the regulatory framework must, however, account for the size of the industry in South Africa. MIS, as an example, employs only 4 analysts in South Africa.

MIS has had an opportunity to informally comment on a Draft Bill in 2011 and appreciates the consideration of our initial comments by National Treasury in the Bill tabled in the Parliament. MIS remains very concerned with a few matters of principle in the Bill and which we would like to draw to the Committee's attention. In the interests of brevity, we set out below our key concerns with the Bill. In Annex I we include a marked-up copy of the Bill reflecting our proposed amendments to the Bill as motivated in this cover letter and in comments to the drafting proposals.

I: Scope of application and the endorsement provision

MIS welcomes the recognition of both CRAs that are located in South Africa and external CRAs that are regulated in third countries. Furthermore, the Bill recognises CRAs that belong to the same group. MIS is concerned, however, that despite this recognition, the Bill creates over-lapping regulatory responsibilities for external CRAs and regulatory confusion for CRAs belonging to the same group. The risk of double regulation should be avoided and MIS would ask the Parliament to make this clear in the scope of the Bill.

Chapter IV of the Bill sets out a framework for CRAs registered in South Africa to endorse credit ratings that are produced partly or wholly outside South Africa by the registered CRA or another CRA belonging to the same group as the registered CRA.

MIS is concerned that the proposed endorsement framework will impose substantial and unnecessary legal and administrative burdens on the FSB and CRAs and make it significantly more difficult for financial market professionals in South Africa to access CRA opinions on a diverse range of issuers and obligations. This is because the endorsement framework essentially duplicates, rather than leverages, the regulation of credit rating services outside South Africa. MIS and other globally active CRAs are already subject to comprehensive regulation of their activities outside South Africa. The Bill presents a number of disincentives for CRAs to endorse credit ratings into South Africa, and if the decision is made by CRAs not to endorse these credit ratings, the range of debt instruments available to South African investors who use credit ratings for regulatory purposes will be materially limited. We also note that, outside the European Union and Japan, no jurisdiction requires the endorsement of foreign credit ratings.

We recommend, therefore, that the proposed scope of application of the resulting Act be adjusted and the endorsement regime be replaced with a streamlined recognition system as follows:

1. Limit the scope of the proposed regulatory framework to credit rating services performed in South Africa.
2. Permit the regulatory use in South Africa of credit ratings produced partly or wholly outside South Africa by external CRAs forming part of the same group as a registered CRA.
3. Grant the FSB the power to approve or decline a request under (2) in whole or on an affiliate-by-affiliate basis.
4. Eliminate the requirements for the CRAs registered in South Africa to endorse credit ratings produced wholly or partly outside South Africa.

II: Civil liability

MIS accepts that CRAs should be subject to appropriate and proportionate regulatory sanctions, in the event of a breach of the provisions of the resulting Act. We already face the possibility of civil actions by third parties (for misleading statements and practices) or criminal sanctions (for offences such as insider dealing) in South Africa. MIS understands that National Treasury has sought to codify the common law civil liability of CRAs in the Bill. Our concern is that the resulting Act, as drafted, could create new and potentially unmanageable private causes of action – beyond the adequate causes of action that are already available in South Africa. As a result of this additional exposure to potential civil litigation, issuers and/or investors may be able to rely on language in the resulting primary and subordinate legislation to raise claims against CRAs simply because, for example, they do not agree with the rating. Using the legislative framework to unduly expose CRAs to civil liability will lead to perverse incentives as claimants seeking to preserve their self interest institute claims against CRAs for a breach of the resulting Act.

The changes proposed could threaten the viability of CRAs, which could have the following effects:

- CRAs, in an effort to protect against litigation, could publish lower ratings or follow volatile market indicators in lock-step;
- Limit participation or deter new entrants in the CRA industry, thereby undermining competition;
- Limit ratings for smaller issuers, high yield corporates, new products and in new markets.

For market participants, the results could be to:
- Raise borrowing costs for many issuers;
- Raise transactions cost for investors by taking away a stable and predictive credit gauge, and replacing it with a volatile or overly conservative rating system.

The liability provisions should not extend liability beyond the ordinary contractual, delictual and other liability under South African law which gives adequate remedies to customers and third parties and only deliberate wrongdoing should be actionable in delict.

We propose the following amendment to section 19 of the Bill:

> ***19.*** *(1) The delictual liability of a ~~A~~ credit rating agency that issues a credit rating or performs credit rating services is limited to liability arising directly from wrongful intent, fraud or gross negligence only ~~may be delictually liable to an investor or a member of the public, in respect of a credit rating issued or credit rating services performed in the ordinary course of business in terms of this Act, for any loss, damages or costs sustained as a result of such credit rating or a credit rating service~~.*
> *(2) Subsection (1) does not affect any additional or other liability of a credit rating agency to an investor or member of the public, arising from a contractual relationship or the application of any law other than this Act.*
> *~~(3) A credit rating agency may not, through a contract, agreement or in any other way, limit or reduce the liability that such credit rating agency may incur in terms of this subsection (1) or in terms of the common law.~~*
> *(3) Subject to subsection (1), a contravention of any provision of this Act does not give rise to any right of action for damages by any person.*[1]

III: Criminal sanction

MIS notes with concern the proposed broad provision in section 32 of the Bill which, through the introduction of the words "*or any other provision*", has inadvertently made the scope of the section inappropriately unlimited by criminalising all contraventions of the resulting Act. Recent legislation has deliberately not criminalised regulated conduct.[2] The FSB pursues a risk-based approach to supervising compliance with respect to its regulatory framework which means that non-compliance with such laws should be graded with only the most serious of contraventions attracting a criminal sanction. This is based on the founding principle that any sanction should be proportionate to the nature of the contravention and the harm caused. For

[1] The proposed amendment to the Bill is not inconsistent with the standard adopted for other opinion providers in the market, such as external auditors. Section 46(4) of the Auditing Profession Act, 2005, for example, contains an express provision that nothing in the section confers a right of action which the person would not have enjoyed already.
[2] National Credit Act, 2005, Financial Advisory and Intermediary Services Act, 2002 and Consumer Protection Act, 2008.

example, the submission of audited financial statements one day after the prescribed timeframe in the resulting Act will be considered an offence. This seems wholly disproportionate and would serve as a strong disincentive for CRAs to register in South Africa. The FSB will not be left without any enforcement powers. To the contrary, for the majority of cases of non-compliance with the resulting Act the FSB will be vested with significant enforcement powers, including the ability to withdraw the registration of an errant CRA.

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MIS would value the opportunity to present its concerns before the Committee. We also look forward to commenting on the subordinate legislation that will be proposed by the FSB. In the interim, please feel free to contact me should you wish to discuss our comments in greater detail.

Yours sincerely

/s/
Frédéric Drevon
Managing Director and Regional Head of Europe, Middle East and Africa

ENCL.

cc: Mr Ismail Momoniat
Head: Tax, Financial Sector Policy
National Treasury of the Republic of South Africa

cc: Adv D P Tshidi
Executive Officer
Financial Services Board

cc: Mr R van Wyk
Registrar of Banks
South African Reserve Bank