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REPUBLIC OF SOUTH AFRICA

RESPONSE DOCUMENT

TO COMMENTS RECEIVED ON THE CREDIT RATING SERVICES BILL

AS TABLED IN PARLIAMENT ON 5 MARCH 2012

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Contents

1 Introduction

National Treasury would like to thank the Standing Committee on Finance for the opportunity to formally respond to the comments raised in oral and written submissions during the public hearings on 29 May 2012.

The respondents made inputs on a number of major themes in the Bill; and provided detailed drafting proposals for particular sections. This document discusses the major themes in section 2, and then in section 3, National Treasury provides a response to each specific comment of the Bill.

2 Major themes in the hearings

2.1 Scope and application (section 3 and 4)

There were a number of comments relating to the scope and application of the Bill. Concern was expressed by commentators that the South African credit ratings services industry would be subject to disproportionate regulation, given the small size of the industry in South Africa. Commentators also noted the strategic objectives of the international credit ratings agencies to expand into Africa, using Johannesburg as a base; and for the smaller ratings agencies to grow business to ensure a competitive and growing industry.

National Treasury is of the view that the Bill is indeed proportionate, but that the intention of the policymaker with regards to the use of approved external credit ratings agencies could be more explicitly stated.

National Treasury has a strategic objective to establish South Africa as a financial centre for Africa. To achieve this strategic objective, the Treasury has a substantial programme of legislation that ensures that the South African regulatory framework remains up-to-date, and benchmarked to the best in the world. This legislation is designed to assist strategic objective in that South Africa will be the only jurisdiction in Africa with a framework for Credit Ratings Agencies that qualifies as equivalent to the European Union regulations. This has already led to almost all of the South Africa ratings agencies positioning their Johannesburg offices as hub offices for the African region. National Treasury and the Financial Services Board support this, and the Bill is designed to create a robust regulatory framework to ensure that ratings agencies can have an appropriate and effective regime to operate in South Africa.

Against this background, National Treasury does not wish to over-regulate the industry such that we overly constrain its growth.

This is of particular relevance to section 3(2) and 4. The Bill as drafted implicitly allows for external credit ratings to be used for regulatory purposes, through appropriate use of section 18 on Endorsement, together with sections 5(3) and 27. However, there is some regulatory uncertainty, and it may require a potential onerous process of application to the Registrar for exemption which creates unnecessary uncertainty. It also creates the odd outcome that an approved external credit ratings agency that undertakes credit ratings services in the Republic should explicitly apply for exemption to conduct these ratings services, even though they are already approved.

To clarify the intention, we propose to the Standing Committee to explicitly introduce external credit ratings agencies approved by the Registrar into section 3(2)

The proposed revised section reads:

Section 3(2) With effect from a date determined by the Minister by notice in the *Gazette*, a person may not perform credit rating services or issue a credit rating that is published in the Republic, unless that person is registered as a credit rating agency in terms of this Act, or is an external credit rating agency approved by the Registrar.

(underline refers to a new addition)

This will allow external credit ratings agencies that are approved by the registrar to operate in South Africa without having to seek special exemption.

2.2 Plain language

A number of commentators were concerned that the plain language requirements were too onerous, particularly as ratings agencies provide opinions on complex securities and financial instruments. On the other hand, National Treasury and the Financial Services Board have a duty to ensure that the users of credit ratings can use them appropriately. Users may include a range of individuals that have varying levels of understanding regarding financial markets, including pension fund trustees and retail investors.

It is the view of the National Treasury that the plain language requirement is not at particularly onerous, and states that a rating is in plain language if:

> *... it is reasonable to conclude that a person of the class of persons for whom the credit rating, policy, code, document or information is intended, with average literacy skills and experience in dealing with credit ratings, information, policy, code or information without difficulty.*
>
> Draft Bill, Section 1(5)(b)

National Treasury submits to the Committee that this strikes a fair balance between the need for understandable ratings, versus the need for ratings agencies to provide detailed technical ratings.

We do not recommend any changes to the section.

2.3 Liability (section 19)

National Treasury notes the extensive comments on the proposed liability provision (section 19). The response to these sets of comments is arranged as follows:

- Rationale for entrenching delictual liability
- Background to delictual liability in South African law
- Liability regime in the United States
- Liability regime in the European Union

2.3.1 Rationale for entrenching delictual liability

It is the express purpose of section 19 to entrench common law delictual liability in the Bill. Essentially, this is the most practical approach as the principles of common law liability are well-established in South African case law. When faced with a claim for liability, the courts will be able to rely on these principles and precedents rather than rely on interpreting legislation.

In the next section, we provide an analysis of the interpretation of the delictual liability provisions in the Credit Ratings Services Bill.

2.3.2 Delictual liability in the Credit Ratings Services Bill – section 19(1)[1]

In South African law, the following elements must be present for delictual liability to arise:

- loss/harm;
- conduct;
- wrongfulness;
- fault; and
- causation.

[1] The subsequent sections are based on a detailed legal opinion provided to National Treasury by Bowman Gilfillan, submissions by Prof Natalia Locke of commercial law at the University of the Witwatersrand, and the opinions of Treasury and Financial Services Board legal counsel. The external opinions are available on request.

2.3.2.1 Loss/Harm

For these purposes, we will deal briefly with patrimonial or pecuniary loss which must exist to be recoverable. Patrimonial loss includes pure economic loss where physical harm to personal property has not occurred. Judges display particular caution in matters involving pure economic loss. Causing pure economic loss, unlike loss to person or to property, is considered prima facie lawful. Policy considerations require liability in delict to be confined to reasonably predictable limits and our courts are particularly cautious about exposing defendants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The approach of our courts is crystallised in the following judgment extract:

> *"A defendant may be held liable ex delicto for causing pure economic loss unassociated with physical injury but before he is held liable it will have to be established that the possibility of loss of that kind was reasonably foreseeable by him and that in all the circumstances of the case he was under a legal duty to prevent such loss occurring. It is not possible or desirable to attempt to define exhaustively the factors which would give rise to such a duty because new situations not previously encountered are bound to arise and societal attitudes are not immutable." (Arthur E Abraham & Gross v Cohen 1991 (1) All SA 92 (C))*

2.3.2.2 Conduct

Conduct may be either a positive act or an omission. Positive conduct may be physical conduct or it may take the form of a statement. These distinctions are of fundamental importance to the law of delict. Although they are all forms of conduct, the policy is to treat them differently for the purposes of legal liability. Liability for omissions is generally more restricted than liability for commissions, and additional policy considerations come into play where, for example, statements, and not physical conduct, cause someone loss. For reasons of public policy, the law is reluctant to assume too readily the existence of a legal duty in these instances.

2.3.2.3 Wrongfulness

Public policy plays an important role in the loss allocation process and the test for wrongfulness is often expressed in the form of the demands of the *boni mores*, or the legal convictions, of society.

The conduct of the defendant must have been wrongful, which is a conclusion of law that a court draws from the facts before it.

Wrongfulness is not part of the requirement that the defendant's conduct must have been intentional or negligent. The concepts are entirely separate and the existence of one does not lead automatically to a conclusion that the other is present.

The criterion to be applied is one of reasonableness, which requires a value judgment The ability of a plaintiff to protect his or her own interests is of particular importance. If, for example, an investor relied on the CRA product beyond the extent that he or she should, or to a careless extent, resulting in harm, it may well be that a court would find it unreasonable to conclude that the CRA conduct was wrongful in a particular circumstance. This is a particularly important test, insofar as it is a G-20 commitment to reduce the reliance on credit ratings, and indeed section 3 explictly states that:

> *(3) This Act does not create a general obligation for—*
> *(a) all securities or financial instruments to be credit rated;*
> *(b) financial institutions or investors to invest only in entities, securities or financial instruments that are credit rated.*

Finally, although a breach of the CRSB which causes loss would not automatically lead to the conclusion that the conduct was wrongful, it would certainly be taken into account in determining wrongfulness.

2.3.2.4 Fault

Once the wrongful character of the defendant's conduct has been established, the question of his or her fault arises, and the existence of either intent or negligence on the part of the defendant forms a basis for imputing the defendant's wrongful conduct to him or her.

There is fault on the part of the defendant if he or she acted either in a reprehensible state of mind or with insufficient care. Fault in the form of a reprehensible state of mind is intent. Fault in the form of inadequate care is negligence.

The law of delict does not distinguish different forms of negligence. The only standard of care which is legally required is that of the reasonable person, with regard to the particular circumstances of the case. Conduct which deviates in even the slightest degree from the standard of a reasonably prudent person is adjudged negligent.

Our courts have authoritatively formulated the test of negligence to be as follows: a *diligens paterfamilias*[2] in the position of the defendant: would foresee the reasonable possibility of his conduct injuring another in his person or property and causing him

[2] "Reasonable man" from the Latin for "head of a family": The way he manages his affairs is presented as a model of caution and prudence

patrimonial loss; and would take reasonable steps to guard against such occurrence; and the defendant failed to take such steps (Kruger v Coetzee 1966 (2) SA 428 (A)).

The general test for negligence is adapted to accommodate situations where skill, being a special competence which is the result of aptitude developed by special training and experience, is required. A person who engages in a profession, trade, calling or any other activity which demands special knowledge and skill must not only exercise reasonable care, but measure up to the standard of competence of a reasonable person professing such knowledge and skill.

2.3.2.5 Causation

An essential element of delictual liability is the existence of a causal nexus between the defendant's conduct and the detrimental consequences sustained by the plaintiff.

Both factual causation and legal causation must be present.

Factual causation relates to the question of whether any factual link exists between the defendant's conduct and the detrimental consequences suffered by the plaintiff. The question is whether the defendant's wrongful act was a cause of the plaintiff's loss.

The purpose of *legal causation* (or the question of remoteness of damage) is to fix the outer limit of liability by determining whether or not a factual link between conduct and consequence should be recognised in law. As a matter of policy, persons are not called upon to make good all the harm that could be attributed to their wrongful conduct. Policy dictates, therefore, that a sufficiently close connection should exist between persons called upon to compensate others.

A concept which is used to exclude legal causation is that of the *novus actus interveniens*. This is an intervening cause which is an independent, unconnected and extraneous factor or event which is not foreseeable, and which actively contributes to the occurrence of harm after the defendant's original conduct has occurred. Such an independent force can take the form of an intervening natural phenomenon, conduct by a third party, or even the plaintiff's own conduct.

Again, the ability of a plaintiff to protect his or her own interests is of importance. If an investor relied on a CRA product beyond the extent that he or she should, or to a careless extent, resulting in harm, it may well be that a court would find this to be a *novus actus interveniens* which would break the causal link between the CRA's action and the harm.

2.3.3 Liability – United States

The framework for regulating credit ratings agencies in the United States is contained in the Dodd-Frank Act. This Act establishes a framework for the regulation of credit ratings agencies that is broadly similar to the approach taken in South Africa[3].

Prior to the passing of Dodd-Frank, rating agencies were exempt from liability under Section 11 of the US Securities Act. Dodd-Frank removes this exemption, and thus exposes rating agencies to expert liability, if they consent to the inclusion of a credit rating in a registration statement. In order to defend against a Section 11 claim, a rating agency would be required to show that it had reasonable grounds to believe, and did in fact believe, that the included credit rating was accurate.

Moreover, Dodd-Frank confirmed the availability of civil remedies against rating agencies in the US Exchanges Act. This was done by aligning these remedies to those that apply to registered public accountants and securities analysts. Dodd-Frank also excludes credit ratings from the protection of the "safe harbor" provisions for forward-looking statements of the Private Securities Litigation Reform Act of 1995.

Dodd-Frank also altered other provisions in the Private Securities Litigation Reform Act of 1995. Previously courts required plaintiffs to plead that the rating agency did not genuinely believe its opinions regarding credit quality or that the opinions lacked basis in fact. This was a very onerous standard, and it was difficult for investors to prove.

A number of cases have been brought in the United States (US) against CRAs for breach of contract and for "the tort of professional negligence".[4] After the 2008 financial crisis there are also a large number of such cases pending against CRAs in the US. In cases against CRAs in the US, the courts have held that the standard for breach of contract and the tort of professional negligence must be reviewed against the standard of "actual malice" of the CRA. Actual malice is a subjective standard requiring the false and defamatory statement to be published with knowledge of falsity or a reckless disregard for the truth. This standard is therefore a higher standard than the South African delictual test for negligence.

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[3] For an analysis of the Credit Ratings sections in Dodd-Frank, see Fernicola and Goldstein (2009) http://www.skadden.com/newsletters/FSR_Credit_Rating_Agencies.pdf ; and for an analysis of the complexities of aligning opinions issued by credit ratings agencies in the US again the Constitutional protection of free speech, see Deats (2011) http://www.columbialawreview.org/assets/pdfs/110/7/Deats.pdf

[4] See for example, County of Orange v. McGraw-hill Companies, Inc., 245 B.R. 149 (C.D. Cal. 1997, Compuware Corp. v. Moody's Investment Services Inc., 499 F.3d 520, 529 (6th Cir. 2007), Jefferson County School District No. R-1 v. Moody's Investment Services Inc., 175 F.3d 848, 856 (10th Cir. 1999), First Equity Corp. v Standard & Poor's Corp., 690 F.Supp.256, 260 (S.D.N.Y 1998).

2.3.4 Liability – European Union

The European Union has recently introduced "CRA3", which is the third version of the regulations that will apply to credit ratings agencies.

In the lead-up to the new version of the regulations, the European Union released a detailed consultation paper[5]. The paper deals in some detail with the liability issue, and puts forward the possibility of a specific provision on the civil liability of ratings agencies, with agencies found to be liable if *"they intentionally or negligently infringe the provisions of the CRA Regulation"* which leads *"to an incorrect rating on which investors have based investment decision".*

The consultation paper further notes that an explicit and clear liability regime is important and brings a number of advantages. A civil liability regime would

> *"improve legal certainty for investors, prevent forum shopping and have a preventive disciplining effect on credit rating agencies."*

Finally, the consultation paper highlights that a civil liability regime is proposed as appropriate for Europe given that it aligns with the provision in Dodd-Frank. Following a comprehensive public consultation process, the EU broadly adopted the proposed changes[6]. Under the new approach, investors will be able to sue a credit rating agency which, intentionally or with gross negligence, fails to respect the obligations set out in the CRA Regulation, thereby causing damage to investors.

Most controversially, the EU has shifted the burden of proof to the CRA to indicate that it has shown the "necessary care". This may create the possibility for "frivolous" legal action, a point made by a number of ratings agencies during the EU and UK consultation processes. To avoid this potentially expensive process, South Africa does not propose the "necessary care" provision.

2.3.5 Exclusion from liability – section 19(3)

A number of commentators, all CRAs, submitted to the Committee that the exclusion of liability condition was inappropriate, particularly as many standard contracts between issuers and CRAs have exclusion of liability provisions. This is a misinterpretation of section 19(3). The section clearly states that

Section 19(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

[5] Available online at http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf

[6] For an analysis of the proposed regulation see http://www.eubusiness.com/topics/finance/credit-rating

agency may incur in terms of this section or in terms of the common law.

The intention is that CRAs should not be able to contract out of their common law liability i.e. with respect to loss/harm, conduct, wrongfulness, fault; and causation.

2.3.6 Conclusion on liability

In conclusion, National Treasury submits to the committee that the current liability provisions are appropriate for the following reasons:

- The liability provisions entrench South African common law, neither raising nor lowering the liability standard. Given the substantial case law, there is adequate legal certainty for both investors and the CRAs as to the tests to be applied;
- They broadly follow international best practice, and strike a balance between the slightly more lenient US standard and the slight more stringent EU standard.

National Treasury submits that there should be no change to the liability provisions.

2.4 Endorsement (section 18)

A number of respondents commented on the provisions contained in Chapter 4, section 18. Global Credit Ratings, an agency based in Johannesburg, expressly requested that international credit ratings agencies should not be exempted from this section, as it may unduly benefit ratings agencies with operations in Europe. A similar concern was raised by FutureGrowth. In contrast, Standard and Poors and Moody's recommended that this section be scrapped entirely, or at the very least completely rewritten, noting that it would entail significant burdens to both Credit Ratings Agencies and to the Registrar of Credit Ratings[7].

The National Treasury submits to the Standing Committee that the respondents misunderstand the intention of Chapter IV. The intention of the chapter is to allow credit ratings agencies operating in South Africa to use credit rating services conducted by other parts of their organisation in jurisdictions that are compliant, oversight regimes in Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore and the United States.

Nevertheless, the National Treasury notes, however, that all the commentators had different interpretations of section 18, which is of great concern. The National Treasury

[7] For each agencies detailed comments, please see section 3 of this document.

does not intend to create confusion in the application of the endorsement regime, or in its use.

National Treasury believes that this can be improved by changing section 4 of the Bill to the following.

Section 4. (1) A credit rating relating to a South African entity, or a security or a financial instrument issued in South Africa, may only be used for regulatory purposes by a regulated person, if that credit rating has been issued or endorsed by a credit rating agency that is registered in accordance with this Act.

(2) A credit rating relating to entities, securities, and financial instruments other than those referred to in subsection (1), may only be used for regulatory purposes by a regulated person if the credit rating has been issued or endorsed by a credit rating agency that is registered in accordance with this Act, or by an external credit ratings agency approved by the Registrar.

(3) The registrar may prescribe additional requirements in respect of the use of credit ratings for regulatory purposes.

The change proposed above will also affect the liability arising from endorsement. It is no longer necessary for local credit ratings agencies to endorse all ratings, only those on South African securities. In any event, these will be generally issued by the South African ratings agency.

2.5 Offences (section 32)

The National Treasury accepts the comments that the current drafting of section 32 is too wide. We propose that this is narrowed to only section 3(2) and section 4.

3 Detailed section-by-section responses

	Sec.	Comment
GCR	Gen	The draft Bill recognizes a "credit rating" to be an "opinion" about the (future) creditworthiness of an entity or a financial instrument and as such a credit rating is subject to a number of variables and factors which can be unknown and complex in nature, for example economic or industry forecasts, which cannot be qualified as incorrect.

National Treasury response: While National Treasury recognises that credit ratings are "opinions", and are to large extent predictions about the future and there will therefore inevitably be times when those predictions prove to be inaccurate, it should be borne in mind that these opinions can have significant and far ranging consequences. The bill does not seek to regulate the content of any such opinion; it only requires that, given the potential for harm emanating from those opinions, that they be formed in good faith, and through rigorous procedures.

Futuregrowth	Gen	We also hold the view that the ratings agencies need Key individual accountability – similar to that required for other fiduciaries like asset managers. We believe that the existing requirements for Key Individuals that is applicable to Asset Managers should apply to rating agencies. **<u>And</u>** We would also like to reiterate our previous comments on accountability, which we view as a very necessary component of this bill. We would like to see the equivalent of "key Individuals" being implemented for credit rating agencies as it leads to personal accountability by natural persons.

National Treasury response: National Treasury is satisfied that the provisions relating to fit and proper requirements (as established in the bill and the draft notices) are sufficient to ensure the integrity of the senior management of CRAs. In addition the

requirement that the King Code on corporate governance be adhered to, will further entrench the principles of accountability and sound corporate governance.

Futuregrowth	Gen	We would also like to see investors having the power to replace the assigned credit ratings agency, without lender approval, which would be subject to a vote, or by a board decision. We would hope to see something similar to that which applies to a companies' auditors, management's ability to replace them, the auditors duty to advise the board of directors that there are no material reasons why they should not be replaced.

National Treasury response: While National Treasury appreciates the similarities between auditors and CRAs in terms of issuing "opinions" which are of great importance to third parties and may have significant impacts, there are important distinctions. Specifically, unlike auditors, CRAs frequently conduct unsolicited ratings in which there may be very limited or no contact with the issuer. There is nothing in the bill which would prevent an investor, who is dissatisfied with a particular CRA or rating, from approaching another CRA to provide a rating of a particular security or issuer. In addition, as was highlighted, in the parliamentary presentations, there is nothing preventing the investor from privately contracting with the issuer for the suggested provision (to be able to replace the CRA by majority vote) to be agreed in a private contractual arrangement.

Furthermore, the Registrar is given broad powers of oversight. If an investor suspects that a particular rating is for whatever reason unreliable, they would be welcome to approach the Registrar who would for example be able to investigate the matter and if appropriate issue a directive requiring that a rating be reviewed.

GCR	def	It is difficult to define precisely what a structured finance instrument is because there is no single, uniform definition. We suggest amending the definition as follows: "means a financial instrument that is of a more complex nature than a standardised financial instrument. Structured finance instruments result from structures and/or

		programmes that are directly and/or indirectly backed by and/or credit linked to certain assets and/or exposures."

National Treasury response: National Treasury is aware of the difficulty in defining the term 'structured finance instrument', precisely because of the lack of uniformity in these products. However we are satisfied that the current wording, with a few minor adjustments, is both specific and broad enough to most appropriately capture the meaning of what we seek to include in the bill. In addition the wording is consistent with that used in other jurisdictions and will therefore aid in ensuring consistency across jurisdictions. The proposed wording is unnecessarily complicated and may lead to confusion.

Asisa	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 categries, excluding any recommendation to purchase, sell or hold any security or financial instrument;" <u>Recommendation</u> The words from " using an established..." should drop down as it should be applicable to paragraphs (a), (b) and (c) of the definition "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 categries, excluding any recommendation to purchase, sell or hold any security or financial instrument;"

National Treasury response: Agreed. This is an error that slipped in during the typesetting process and is not intentional.

GCR	1(5) and 10	The end-users of credit ratings are sophisticated parties active in the financial markets and are not "the average man in the street". Such sophisticated parties should not be excluded from any responsibility when using credit ratings by enacting legislation that seems to put responsibility only on the shoulders of the credit rating agencies. **And** We propose to remove this requirement from the Act. It will be very difficult in practice to write credit rating reports that would qualify as "plain language" for every potential reader. As section 19(1) suggest that "any member of the public" could sue a credit rating agency, this would mean that also persons that are not sophisticated participants of financial markets can sue and could claim that the language used was not "plain" for them.
Fitch		Users of Credit ratings Fitch's ratings are intended for the wholesale, rather than the retail market. That is, users of our ratings are sophisticated financial market participants. We are therefore concerned with any provisions of the Draft CRA Bill that might imply otherwise – see for example, clause 1(5)(b) and clause 10(1)(b)(ii)

National Treasury response: National Treasury is satisfied that since for the purposes of the Act plain language is defined as " a credit rating, policy, code, document or information is in plain language if it is reasonable to conclude that **a person of the class of persons for whom the credit rating, policy, code, document or information is intended**, with average literacy skills and experience in dealing with credit ratings, credit rating services and credit rating agencies, could be expected to understand the content, significance and import of the credit rating, information, policy,

code, document or information without difficulty..." (emphasis added) and not for "the average man in the street", that these concerns are adequately addressed in the bill.

It should also be noted that there is no requirement that it be "plain" for *every* potential reader, just that it be plain enough that it can be *reasonably assumed that an average reader of the class for whom it is intended* should be able to understand it. If any particular reader within that class does not understand that would not be sufficient for a civil claim to be successful.

In addition as different types of investors will rely on credit ratings to differing degrees (for example collective investment schemes have different needs to insurance funds), it is more appropriate that the level of responsibility that they should carry, and to what extent they are permitted to rely on credit ratings, be clarified in industry specific legislation and subordinate legislation.

Maitland	3(1)	We have a concern that the Bill may in its current form extend to include the provision of ratings advisory services by companies to clients who are preparing or plan to obtain a credit rating from a registered credit rating agent. In terms of the Bill the definition of "credit rating services" means data and information analysis, evaluation, approval, issuing or review of credit ratings. Section 3(1) of the Bill states that "this Act applies to 3(1) (a) credit rating services performed in the Republic..... and 3(1) (c) any person that performs credit rating services.... "

		Our concern is that the definition of credit rating services appears wide enough to include the activities of ratings advisory services by entities that are not credit rating agencies and who have no intention of providing a credit rating. It could be interpreted that section 3(4) will exclude ratings advisory from the definition in that ratings advisory will always be private advice provided exclusively to a client and is not intended for publication. However, this subsection refers to "private credit ratings" and not to "credit rating services". Ratings advisory services on their own do not lead to a credit rating but merely assist a client in assessing the likely rating that may be obtained should it then proceed to request a credit rating from a credit rating agent. I understand from discussions with the FSB that this is not the intention of the Bill. The Memorandum on Object of the Bill would appear to support this view.

National Treasury response: During the consultation phase of drafting numerous comments, similar to this one, were received from entities that are not credit rating agencies but perform services that are sufficiently similar that they may be included in the definition. In general, National Treasury is satisfied that the majority of these services are not inadvertently captured by the Bill.

However, to the extent that the Bill may unintentionally cover such activities it is felt that it is better to keep the current definition and to either grant exemption to particular entities or to certain activities altogether (e.g. through subordinate legislation) than to make the definition more specific and run the risk of excluding activities that ought to be included.

ASISA	4	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 regulated 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 to limit misinterpretation: "Where a regulated person uses 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"

National Treasury response: Agreed. The suggested wording should be incorporated for clarity.

S&P	5	**Fit and proper requirements for employees (Chapter 2, Section (5)(1)(d))** We question the need for imposing fit and proper requirements on individual employees of CRAs as set out in Section (5)(1)(d). The Code of Conduct Fundamentals for Credit Rating Agencies set out by the International Organization of Securities Commissions (the "IOSCO Code") provides that analysts should be held to high standards of integrity and a CRA should not employ individuals with demonstrably compromised integrity. S&P Ratings Services requires all employees to comply with the S&P Ratings Services Code of Conduct and related policies, procedures and guidelines. Employees are required to formally affirm their compliance with the Code and related documents. Failure to comply with company policies, procedures and guidelines may result in disciplinary action, up to and including termination of employment. S&P Ratings Services is committed to the ongoing education and development of its credit rating analysts and in 2009 we introduced an Analytical Certification Programme which all analysts must pass in order to act as a primary analyst on a rating or to vote in a rating committee. Rather than inappropriately requiring CRA analysts and other employees to meet broad fit and proper requirements, an alternative approach is to require that CRAs demonstrate to the Registrar how analysts maintain high standards of training and how analysts and other employees are held to high standards of integrity.

National Treasury response: It is necessary to specify broad fit and proper requirements to ensure that the same minimum standards are applied uniformly to all CRAs. While we appreciate that each CRA will in all likelihood have its own (stringent) internal standards, it would not be possible for the Registrar to determine whether a particular individual meets a consistent, impartial threshold without first specifying what that threshold is.

Futuregrowth	5	Para 5(1)(d)- The fit and proper compliance requirement should include confirmation or disclosure that the directors are independent from issuers and users of ratings and that there are no conflict of interest with issuers.

National Treasury response: Such a requirement is more appropriately specified in subordinate legislation.

Futuregrowth	5	Para 5(3) – The Registrar may exempt an applicant who, or whose holding company, or a related company in the same group is registered, authorised or approved by a foreign regulatory authority as a credit rating agency from providing some or all of the information required under certain provisos. Our understanding is that effectively this may allow for three major rating agencies namely Moody's, Standard & Poor's and Fitch, to be exempt if the Registrar so approves. Given the intention of the Bill (principles of accountability, transparency, governance, etc), we would like the assurance that this exemption will not apply to the aforementioned rating agencies at the outset and implementation of the Bill.

National Treasury response: It should be noted that this exemption only applies to information submitted during the application process, not from the application itself. Furthermore, in order to properly fulfil his/her functions, the Registrar will have to evaluate each request for exemption on its merits, on a case by case basis, and there will definitely be no automatic exemptions. While we are mindful of the need to avoid imposing 'double' regulation and compliance costs on CRAs that operate internationally, there is certainly no intention to effectively outsource the regulation of South Africa's credit ratings industry to a foreign regulator.

Futuregrowth	5	Para 5(4) The Registrar must give notice of the receipt of an application for registration on the FSB official website, which notice must state: (a) the name of the applicant; and (b) the period within which objections to the application may be lodged with the registrar. Our view is that simply providing the name of the applicant without sufficient supporting information does not provide investors with a means to object. In order for the public to apply their minds and be in a position to object or not, the public should have access to the same information that the Registrar has been provided with in terms of Para 5(1). As a minimum, the public should have access to i) the ownership structure ii) organisational structure and corporate governance, (iii) subsidiaries, if any; (iv) resources and expertise to perform credit rating service programme of operation, including indications of where the main business activities are expected to be carried out, branches to be established, and the type of business that will be undertaken.

National Treasury response: The argument in favour of more extensive disclosures rests primarily on the benefit of increased transparency, while those opposing them argue that there is the potential for undue reputational harm, should an application be withdrawn or delayed, for example. While the objective of transparency is noted, this needs to be balanced with the rights of the applicant. It is felt that much of the suggested information is of a competitive nature and should not, as a matter of course, be made public. However, in order to maintain consistency with other legislation administered by the FSB, the name of the applicant will still be publically disclosed.

However, while the information will not be publically disclosed, the evaluation of the application is a regulatory function of the Registrar, and as such this sort of information will still have to be taken into account in determining whether an application should be approved.

Futuregrowth	6	Para 6(5)(a) Credit ratings issued by a credit rating agency whose registration has been suspended or cancelled may continue to be used for regulatory purposes subject to certain provisos.

		Our view is that the prescribed time frame of three months under Para 5(a)(iii) for which the ratings remain valid is very restrictive for investors. This is based on our experience that there is generally a protracted process before an alternate credit rating agency is appointed, for the alternate credit rating agency to then perform their review and ultimately publish ratings, especially on complicated structured transactions or for issuers that the alternate credit rating agency does not cover. There could be serious repercussions in terms of mandate requirements if an instrument becomes an unrated instrument. Furthermore, should there be any doubt cast over a credit rating agency, investors would then need to apply their minds as to whether they may rely on any ratings published by a specific credit rating agency as a whole. It is therefore suggested that unless there has been misconduct, negligence and/or fraudulent behaviour committed by the credit rating agency, its directors and or the issuer in the determination of the rating, that the rating as published will remain in force and effect until the sooner of the review date of the rating in question or the date on which an alternate rating is published – but in either case subject to a maximum time frame of 12 months which should be adequate time to allow for an alternate rating to be issued. While we understand that the Registrar may extend the period referred to in paragraph 6(5)(a)(ii) In order to mitigate any potential market disruption or to ensure financial stability, investors are not involved in this process. Therefore, if there are logistical, administrative or legal conditions for the Registrar to approve and implement an extension, it may have an impact on investor mandates and the intention is to avoid this scenario

National Treasury response: While we understand that the issuing of a rating is not immediate, we do not believe that under normal circumstances it should take longer than the prescribed three months, and the need for urgency in such a case would be paramount. Even in cases where the suspension/cancellation is not directly as a result of "misconduct, negligence and/or fraudulent behaviour" suspension/cancellation will only occur in extreme cases (of for example non-compliance with the regulations) and may therefore be an indication that other ratings by that CRA may not be reliable. As such it is necessary that the rating be replaced as soon as possible. In any event, should three months prove to be inadequate in any given case, the Registrar has the discretion to extend the timeframe under section 6(5)(a)(ii). It is not clear from the comment what sort of "logistical, administrative, or legal obstacles" might prevent the Registrar from exercising this power.

Futuregrowth	7	Para 7 (1)(j) the credit rating agency must establish a unit within its organisation whose function is to communicate with investors, potential investors and the public about any questions, concerns or complaints that it may receive. While we appreciate the need for a central communication i.e. an "investor relations" department we need to ensure that investors will continue to have access to the credit rating analyst(s) and that investors may communicate directly with a credit rating analyst post the advent of an investor relations department individuals (including at a minimum the MD/ CEO and the relevant analyst)

National Treasury response: The requirement for a communication unit does not preclude further forms of communication between investors and CRAs. Investors and CRA's will still be able to establish whatever additional channels of communication they deem to be necessary as a private arrangement, and it is inappropriate for these arrangements to be legislated.

Futuregrowth	10	Para 10(1)(a) - credit rating agency must publish any credit rating or any decision to discontinue a credit rating impartially and timeously.

		The definition and determination of "timeously" would vary between credit rating agencies and we feel, given our business needs that this requirement is too vague and allows a credit rating agency unwarranted discretion. A more prescriptive time frame to discontinue a rating is recommended and we suggest that a credit rating agency provide 7 days' notice to investors that it will discontinue a credit rating.

National Treasury response: This provision has been left fairly broad as the question of what is an appropriate timeframe is likely to be highly context dependent, varying not just across different CRAs but also for different issuers, types of securities, the availability of information, etc. Whilst it is not possible to prescribe a specific time frame, the inclusion of the 'timeous' requirement would allow the Registrar scope to sanction a CRA for any unjustified delays in publishing such information.

In addition should this provision prove to give too much discretion to the credit rating agencies, the Registrar has the power to specify a timeframe in subordinate legislation

Futuregrowth	10	Para 10(1)(c) - a credit rating agency must monitor credit ratings and regularly review its credit ratings. We suggest that the "regularly review" should be changed to "continuously review" given the dynamic market conditions in which markets operate. As a minimum this change could be implemented for new market events, so that credit ratings are continuously assessed for current market trends and events

National Treasury response: The requirement to "continuously" review ratings is an impossible standard. In addition "regularly" is consistent with the wording of regulation in other jurisdictions.

Futuregrowth	10	Para 10(4) a credit rating agency must refrain from issuing a credit rating if the lack of reliable data, the complexity of a new type of financial instrument or the quality of information available may result in a non-credible credit rating. We feel that this should also extend to a credit rating agency being obliged to withdraw an existing rating for the abovementioned reasons. We therefore suggest that the wording be amended to include the underlined reference "from issuing a credit rating or must withdraw an existing or preliminary rating if the lack of reliable data, the complexity of a new type of financial instrument or the quality of information available may result in a non-credible credit rating".

National Treasury response: As a CRA has the ability to alter a rating (including the option to withdraw) based on the information on at its disposal, is already required to regularly review its ratings, and is required to determine ratings in good faith, it is felt that a strict requirement to withdraw a rating is unnecessary and may result in unnecessary disruption to the market.

Futuregrowth	11	Para 11 – A credit rating agency must adopt, publish and adhere to a code of conduct. We suggest that this be extended to include para 11(c) that the credit rating agency must describe how they will adhere to this Act. We also recommend that a minimum standard for a code of conduct is included in the legislation, and each rating agency should as part of the disclosure in para 13(1) detail instances where the minimum standards were not adhered to, the reasons and corrective action taken. Furthermore we would support the establishment of a hotline or email address where investors and/or other interested parties can send the Registrar details of any matters that require the Registrar's attention and/or possible action.

National Treasury response: It is unnecessary for a CRA to describe how they will adhere to this Act. As a legally binding statute they simply must comply, or face appropriate sanction. This is in contrast to a code of conduct which is generally aspirational, not mandatory. In addition the draft rules require that a CRA submit a compliance report to the Registrar detailing compliance with the Act. The prescription of a 'minimum standard for a code of conduct' is more appropriately dealt with sub-ordinate legislation.

Futuregrowth	12	Para 12(1) – It is recommended that a credit rating agency is required to inform investors if they have outsourced a credit rating, to which party they have outsourced this credit rating and if this party is a regulated entity.

National Treasury response: This sort of provision is more appropriately dealt with in subordinate legislation.

Futuregrowth	13	Para 13(1) A credit rating agency must disclose to the public and its subscribers certain information. It is recommended that this be extended to include disclosures on directors, management, shareholders, ownership structure and any changes herein.

National Treasury response: The necessary public disclosure for particular types of companies is more appropriately dealt with under the Companies Act, and is beyond the ambit of this legislation. Given that the registrar, as regulator, will have access to such information it is not felt that the concern is sufficient to override the provisions of that Act.

Futuregrowth	13	Para 13(2) a credit rating agency must, every 12 months, disclose to the public and its subscribers data about the historical default rates of its ratings categories.

		We note that the time period has increased from 6 months to 12 months from the original proposal. Given current market conditions and the need for updated relevant information, it is suggested that this time period revert to the original proposal of 6 months given the current market conditions

National Treasury response: It is felt that a 12 month period is more appropriate. Firstly, feedback from the CRAs has indicated that such information is not always available at more frequent intervals. In addition, as many other jurisdictions require only annual disclosure, a requirement for more frequent submissions will greatly add to the administrative burden on CRAs operating internationally, for very little if any, additional benefit.

Futuregrowth	13	Para 13(4)(a) – a credit rating agency must annually disclose to the registrar a list of its 20 largest clients, and the percentage of revenue that each of those 20 clients, individually or together with affiliates, contribute to the total annual revenue of the credit rating agency The requirement to disclose the "20 largest clients" needs to be clarified to rather read the "20 largest clients by revenue"

National Treasury response: Agreed. Recommended change should be incorporated.

Asisa	16	<u>Independent compliance unit</u> 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.

National Treasury response: Agreed. Section 16 should explicitly include an enabling provision that empowers the Registrar to determine the process for approval in subordinate legislation.

Fitch	16 (8)	Compliance Officer Notifications Clause 16(8) provides that the compliance officer must notify the registrar of any irregularities (or suspected irregularities) in the conduct or affairs of, or any breach of the Draft CRA Bill by, the CRA. In the original draft there was a materiality qualification, which makes sense to us. However, that qualification has been removed. We believe it should be reinstated.

National Treasury response: Including a materiality threshold allows the applicant a degree of discretion in determining whether to inform the registrar of a particular change. It is the National Treasury's opinion that the determination of whether any given change is 'material' can and should only be made by the Registrar.

Fitch	18	Endorsement We appreciate that section 19 of the Draft CRA Bill is based on the

		comparable provision in the EU Regulation. However it is not clear to us why this is necessary for South Africa. We do not know whether, and if so how, regulated entities in South Africa use Fitch ratings for regulatory purposes. We assume that if they do so use Fitch credit ratings, these entities are interested only in certain international ratings. As explained above, Fitch's international rating are produced in accordance with global policies and procedures that are consistent with the EU regulation. To the extent that the Draft CRA Bill is based on the EU regulation, the extra step of endorsement by Fitch Southern Africa would not change how these credit ratings are produced. On the other hand, to the extent the Draft CRA Bill provides for additional and/or contradictory provisions, it might become too difficult (or impossible) to endorse these international credit ratings.
MIS	18	**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.
S&P	18	Endorsement of External Credit Ratings (Chapter 4, Section 18) An endorsement regime has been established by the EU Regulation as a mechanism for permitting the use – in the EU for regulatory purposes - of credit ratings issued in third countries, which is designed to allow a CRA established in the EU to endorse such a rating provided that certain conditions are complied with. The EU endorsement regime is particular to the EU. We consider that the endorsement regime currently proposed in South Africa (as set out in Chapter 4) gives rise to considerable uncertainty as to its application and would be very difficult to operate in practice. If established in South Africa, it would require a registered CRA to verify and be able to demonstrate on an ongoing basis that the third country CRA conducts its credit rating activities in compliance with requirements that are "equivalent" to certain specified requirements under the Bill, including the requirements on conflicts avoidance, monitoring and reviewing its existing credit ratings and disclosures. On an ongoing basis, whilst the endorsement is in force, endorsement will be extremely onerous as detailed compliance by the third country CRA may be difficult to ascertain, monitor and enforce by the South African CRA. In addition, the proposed endorsement regime provisions also require the third country CRA to be subject to a regulatory regime in its home country and for co-operation agreements between the third country regulator and the FSB to be in place. These requirements are entirely outside a CRA's

		control. The endorsement regime will effectively promote double supervision (i.e. by the registrar and the third country regulator) which is not only unnecessary but also an inefficient use of resources. In practice, this seems to apply the Bill extra-territorially. The setting up of an operational framework to adequately address endorsement requirements would put a considerable strain on resources and is wholly disproportionate given the size of local markets including the size of S&P South Africa. This in turn could ultimately lead to inefficiencies, market dysfunctions and constraints on capital flow. This is particularly relevant in the South African context where there is a high reliance on accessing foreign markets for funding. We can see no demonstrable benefit for adding to the regulatory burden in that way. In all, we consider that the endorsement regime as set out in Chapter 4 of the Bill is wholly inappropriate for South Africa and contradicts the purpose of the Bill. We therefore respectfully suggest that the Standing Committee on Finance consider removing this Chapter from the Bill or amending it substantially. For substantial amendment, it could be considered for example, to allow for exemptions of this endorsement regime for a CRA such as S&P South Africa that is part of a global CRA group which is already subject to an endorsement regime elsewhere. ESMA has now established that the CRA oversight regimes in Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore and the United States are equivalent to the requirements of the EU CRA Regulation. If the National Treasury or the registrar were to determine that the requirements of EU CRA Regulation were equivalent to those of the Bill, then the credit ratings endorsed by the EU based CRA (S&P CMS Europe in our case) would automatically meet the equivalence test for South Africa. Correspondingly, it should suffice for the registrar to make an equivalence assessment of the EU CRA Regulation and to agree a cooperation agreement with ESMA, so that the registrar and the CRA can meet the objectives of Chapter 4 without substantial unnecessary burden.

National Treasury response: The intention of this provision is i) to ensure that the Registrar is satisfied that ratings that are published and used in South Africa have been produced under a regulatory regime that is sufficiently stringent and ii) to ensure that where ratings are used in South Africa, there is a local presence over which the Registrar will be able to exercise his/her regulatory powers and who can be held accountable.

That said, as noted in our detailed response in section 2,4, we accept that the scope and application of the Bill should be limited to South African securities, debt instruments, etc., and we have narrowed this accordingly in our proposed changes to section 4.

However, should the endorsement regime prove to be too onerous the Registrar does have the authority to grant exemptions. Furthermore as more countries implement regulatory regimes, the endorsement requirement may become less relevant. This section can be revisited and reviewed as post application progress with the Act is made.

GCR	19(1)	Is it possible to clarify why "member of the public" is included in this clause? It is not understood why an unspecified member of the public should have the opportunity to start a lawsuit against a credit rating agency? This is particularly onerous given the provision on Page 5 Point 5(a)(ii) that requires the use of 'Plain language' as it could be reasonably assumed that not all members of the public 'have average literacy skills and experience in dealing with credit ratings ....'., [the latter clearly stated in the draft Bill]. We therefore suggest the following wording '...to an investor, in respect of ...'

National Treasury response: The clause is intended to allow members of the public, who are users of credit ratings and are reliant upon them, recourse to legal action. Please refer to the response to the plain language comments above.

GCR	19(1)	We note National Treasury's comment that the existing standard of delictual liability under the common law has been incorporated into the Act. However, the fact that credit ratings and credit rating services will now be regulated in terms of the Act significantly alters the legal framework in which CRA's will operate and is

		likely to effect, in particular, the test for wrongfulness to be applied by our courts in relation to the delictual liability of a CRA. In these circumstances, we are of the view that it would be reasonable to restrict the delictual liability of CRA's to failures to comply with the Act arising from acts or omission of wilful default or gross negligence by the CRA and which have an impact on the rating outcome. This also follows the approach which is likely to be adopted in the equivalent EU Regulations. We therefore suggest that section 19(1) be replaced with the following: "A credit rating agency may be delictually liable to an investor if such investor suffers any loss, damage or cost caused by the credit rating agency deliberately or with gross negligence failing to materially comply with any provision of this Act, and which has an impact on the credit rating on which such investor has relied."
MIS	19	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 o performs credit rating services is limited to liability arising directly from wrongf intent, fraud or gross negligence only ~~may be delictually liable to an investor or member of the public, in respect of a credit rating issued or credit rating servic performed in the ordinary course of business in terms of this Act, for any los 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 relationshi 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]
S&P	19	Liability of credit rating agencies (Chapter 5, Section 19) CRAs are legally accountable in the same way as other market participants. Any business that intentionally misleads or defrauds investors can be held liable under securities fraud laws, and CRAs are no exception. CRAs should not be subject to discriminatory or higher standards of liability relative to other market participants. Otherwise, new ratings providers may be discouraged from entering the market and ratings may be restricted for riskier credits. Any private rights of action against CRAs that may nonetheless be passed under the Draft Bill should be limited to material breaches of the applicable legislation and regulation. Inevitably, minor breaches may occur and be remedied through dialogue with the registrar. It would not be justified for any such minor breach to create a threat of potential law suit from private third parties. Liability towards third parties should only result from a material failure to have in place appropriate processes and control systems, provided that such material breach caused a loss to the

		plaintiff in accordance with the general rules of South African law.. Prohibiting limitation clauses and disclaimers is unnecessary and would be discriminatory as the principle of contractual freedom allows the parties to provide for clauses excluding or limiting their liability. In our understanding, other participants in the finance industry are allowed to exclude or limit their liability by contract: auditors, investment banks, asset managers etc. The proposed prohibition would constitute a discrimination compared with these other sectors. It would also mean that CRAs can be sued more easily than other parties who actually participate in the underwriting and sale of debt securities, unlike CRAs who are independent opinion-givers. Limitation of liability is also necessary, and acknowledged by other CRA regulations such as in the EU Regulations, given CRAs' reliance in rating analysis on third party information provided by issuers and their agents and advisors. CRAs do not perform an audit or verification of this information and therefore rely upon others for its accuracy or completeness. The provision of accurate and reliable information is a fundamental obligation of the issuer under the rating agreement.
GCR	19(3)	It is common practice to use disclaimers and disclose the limitations of the credit rating and/or credit rating process. Sophisticated investors who are in effect the users of credit ratings should be able to understand what a credit rating means and what its limitations are. To state in the Act that a credit rating agency is not allowed to "in any other way" limit or reduce its liability is not appropriate because a rating is merely an opinion, based on an assessment of complex factors, including economic and political factors, none of which can be qualified as incorrect. A rating agency is also reliant on the issuer providing accurate and reliable information. These limitations should be clearly outlined in all published documentation.

National Treasury response: National Treasury is satisfied that, by codifying the already existing standards of common law, the draft Bill imposes an appropriate standard of liability. All the elements of delict will have to be proven, including culpability, unlawfulness and legal causality (a requirement that is notoriously difficult to meet in the context of auditors' liability). Given the need to prove legal causality, we do not believe that the resulting standard of liability is unnecessarily stringent – it would be extremely difficult for a plaintiff to demonstrate that anything but a major breach of the resulting law was the legally attributable cause of their loss.

In addition, given that the standard for liability is delict it is not felt that the limitation on 'contracting out of liability' is unnecessarily stringent, as it is not legally possible to contract out of such liability under common law. In all likelihood a 'disclaimer' stating the circumstances under which the rating was assigned and describing its limitations would make proving legal causality even more difficult for a would be plaintiff, but we do not believe that a CRA should be able to absolve itself of all responsibility.

Futuregrowth	23	Para 23 – It is suggested that this should be amended to also include a para 23(j) the duty on the Registrar to impose fines for non-compliance with this Act and a para 23(k) that the Registrar must receive and act on information received from investors In the latter instance we see this as being applicable, for example if an issuer comes to the debt market on the back of a credit rating but within a short period thereafter the issuer is subsequently downgraded. This to our minds constitutes misrepresentation by both the issuer and the the credit rating agency as a) the issuer would be aware of any rating action pending but does not inform investors and b) the rating agency should be aware that the issuer is coming to market and should be proactive and advise investors of possible rating action pending.

National Treasury response: The recommended provisions are not appropriate. The Registrar is only empowered to impose administrative penalties (for example for late submissions). Cases of non-compliance are referred tothe FSB's enforcement committee, which is empowered by other legislation (specifically the FSB Act and the Financial Institutions Protection of Funds Act) to impose fines. The recommendations are therefore beyond the scope of this Act.

The requirement that the Registrar receive and act on information from investors is unnecessary. The Registrar is by definition the regulator of this industry and must therefore act on all pertinent information he/she receives.

Fitch	27	**Exemptions**

		We welcome the proposed ability for the South African members of international credit rating agency (CRA) groups such as Fitch Southern Africa, (Pty) Ltd. ("Fitch Southern Africa") to be exempted from the application requirements. Fitch Southern Africa's parent, Fitch Ratings Ltd (an English company) ("FRL"), is registered under the EU Regulation with respect to CRAs. Moreover, Fitch has implemented global policies and procedures with respect to the issuance and modification of credit ratings, consistent with EU regulation, which apply to all international ratings issued by Fitch CRAs including Fitch Southern Africa. Given that the: Draft Bill is based directly on the IOSCO Code of CU Regulation (which itself is based on the IOSCO code) we would strongly urge that the Fitch Southern Africa (and other CRAs in a similar situations) be granted permanent exemptions from all requirements under the Draft CRA Bill with respect to its international scale ratings. Indeed we believe, in the case of such CRAs that the Draft CRA Bill should explicitly apply only to their South Africaan national scale credit ratings -

National Treasury Response: It should be noted that exemption is for certain provisions of the Act, not from "all" application requirements of the Act.

Given that both national and international scale ratings are utilised in South Africa it is not appropriate for international scale ratings to be excluded from the scope of the Act.

MIS	32	**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 (National Credit Act, 2005, Financial Advisory and Intermediary Services Act, 2002 and Consumer Protection Act, 2008.) 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 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.
GCR	32(a)	The addition of the words "or any other provisions of this Act" is in our view a surprising and alarming new amendment proposed by National Treasury. It essentially means that any person who commits even the most minor infringement of the Act (even unknowingly and which may easily be remediable) will be guilty of an offence. Clearly the ambit of the statute is much too wide and in many instances the offence is likely to be manifestly inappropriate to the potential sentence that may be imposed, which includes a prison sentence of up to 10 years. We therefore suggest that, as in other similar statutes, for example in Europe, the ambit of the section should be limited to offences arising from infringements of certain, specified provisions of the Act and not just any provision of the Act. Furthermore, we are concerned that there is no express element of mens rea in the proposed wording. We therefore propose that the wording "or any other provisions of this Act" be amended as follows: "or deliberately contravenes or materially fails to comply with the provisions of this Act, where the infringement in question affected the outcome of the rating". Or an alternative option could also be, "or deliberately contravenes or materially fails to comply with the following provisions of this Act: [•][Insert specific sections of the Act], where the infringement in question affected the outcome of the rating'.

National Treasury response: Agreed. The words "or any other provision of this Act" should be removed so that only contraventions of provisions 3(2) and 4, should be criminal offences.

Futuregrowth	32	Para 32 – we note that the amount of the fine has been removed (previously capped at R100,000). It is recommended that a minimum fine amount be prescribed with the registrar having the discretion to recommend a higher fine be imposed depending on the circumstances and the information the Registrar has on hand

National Treasury response: It is felt that specifying guidelines for the fines is more appropriately dealt with in subordinate legislation, under fees and penalties.

GCR	32(c)	The current wording is too wide, particularly in relation to furnishing "false" information. For example, the "false" information may arise from a simple typographical error without any intent or malice on the part of the person giving such information. We would therefore suggest that the wording be amended as follows: "Deliberately gives an auditor or compliance officer information which is false, misleading or conceals any material fact."

National Treasury response: The intention is that due care be exercised in providing such information. Furthermore it may be extremely difficult to prove that certain information was intentionally false. However, if it is clear that a simple mistake has occurred that would certainly be taken into account when administering a fine.