



PRACTICE NOTE issued pursuant to the Guidelines on the Offering Of Private Debt Securities and the Guidelines on the Offering Of Islamic Securities

Issued Date: 25 January 2006

Recognition of Credit Rating Agencies by the Securities Commission for the Purpose of Rating Bond Issues

1.0 INTRODUCTION

- 1.1 This Practice Note sets out the regulatory requirements and procedures for recognition as a credit rating agency by the Securities Commission (SC).
- 1.2 Pursuant to the Guidelines on the Offering of Private Debt Securities and the Guidelines on the Offering of Islamic Securities, a recognised credit rating agency shall be an entity recognised by the SC in accordance with this Practice Note.
- 1.3 Under this Practice Note, the term “credit rating agency” or “CRA” means an entity which is recognised by the SC to provide credit ratings for bonds on an independent and objective basis.
- 1.4 For the purposes of this Note, bonds include all corporate bonds and Islamic securities approved by the SC.

2.0 RECOGNITION CRITERIA

- 2.1 A CRA shall meet the following minimum criteria in order to be recognised by the SC:

- (a) **Capital requirement and financial resources**

A CRA shall maintain minimum shareholders’ funds of RM10 million, or such amount as may be specified by the SC, at all times and have

sufficient financial resources to operate independently and to withstand economic and financial pressures.

(b) Shareholding structure

A CRA shall have an appropriate shareholding structure that will ensure and maintain its independence and objectivity in rating bonds.

(c) Rating methodology and process

(i) A CRA shall use established rating methodologies and processes that are robust, systematic and apply them consistently. Rating methodologies shall be modified and tailored for each type of bond and industry to which they are applied. A CRA shall, where relevant, incorporate corporate governance analysis into its rating framework to assess any impact on credit risks.

(ii) A CRA shall establish, maintain and implement written policies, controls and procedures that ensure high quality and integrity of its rating process. It shall have in place systematic procedures designed to ensure that its analysts are able to reasonably identify, understand and analyze information relevant to the bond issue to produce thorough and fair credit opinions.

(iii) A CRA shall establish rating committee, comprising members who are adequately qualified and knowledgeable to assign and decide on bond credit ratings. All rating decisions, including decisions regarding changes in rating, shall be taken to the rating committee.

(iv) A CRA shall structure its rating teams and process to promote continuity and consistency in the rating process.

(d) Transparency and disclosure

(i) A CRA shall ensure that its rating methodologies, criteria and rating process are made known to investors and the public in general. It shall include the rating philosophy or approach adopted, the parameters which are considered and benchmarks used, where applicable. A CRA shall also publish details on how the rating process is conducted and the steps that are followed before a rating is assigned.

- (ii) A CRA shall publish its rating opinions in a timely manner and adequately disclose all information to support its rating opinions which include, but not limited to, assumptions and rationale of its opinion.
- (iii) A CRA shall establish, maintain and implement written policies, controls and procedures that ensure adequate, proper and timely disclosure of all rating opinions and information.
- (iv) The rating reports shall contain all pertinent information with sufficient analytical depth. In this regard, rating reports shall at least contain information on the bond issue and issuer as well as critical rating factors considered – both quantitative and qualitative. Where relevant, the rating reports shall include disclosure of any benchmarks used, any sensitivity analyses performed and their results, comparative analyses made with other industries or companies and disclosure of any credit enhancements.
- (v) A CRA shall clearly disclose its definition of “default”. It shall be made clear whether a particular rating measures timely payment of debt obligations or includes recovery values expected after a default.

(e) Independence, objectivity and conflict of interest

- (i) The management of a CRA shall perform its duties free of undue intervention or influence from its shareholders. In addition, the Board of Directors and management of a CRA shall exercise care and diligence in discharging their duties to maintain the independence and objectivity of the CRA.
- (ii) A CRA shall establish, maintain and implement written policies, controls and procedures to maintain its independence and minimise the effects of any possible conflicts of interest. The independence, credibility, objectivity and integrity of its operations shall be adequately protected by these policies and procedures. These policies and procedures shall identify and eliminate, or manage and disclose, as appropriate, actual or potential conflicts of interest that may influence the opinions and analyses or the judgment of their analysts.
- (iii) Where the analyst or rating committee member, or any of his family member, has an interest in the bond issue, the analyst or rating committee member of a CRA shall not be involved in the rating and monitoring process or decide on ratings.

- (iv) A CRA shall establish appropriate policies and procedures governing investments in and trading of securities by its employees.
- (v) A CRA shall have adequate procedures and mechanisms in place to ensure that its ancillary business (if any) do not lead to a conflict of interest situation.
- (vi) A CRA shall disclose all material conflicts of interest to the public in its rating reports.

(f) Monitoring of bonds rated by CRAs

- (i) A CRA shall establish, maintain and implement written policies, controls and procedures to ensure that all bonds rated by it are diligently and vigilantly monitored on an on-going basis. Ratings shall be monitored such that any change in the issuer/issues' situation is reflected in the assigned rating.
- (ii) A CRA shall conduct rating reviews of outstanding bonds and publish its rating opinions and reports on a timely and consistent basis. Rating upgrades and downgrades from a CRA shall be timely.
- (iii) Notwithstanding paragraph 2.1(f)(ii), a CRA shall initiate immediate review of rating status upon becoming aware of any information that may reasonably be expected to result in a rating action.
- (iv) A CRA shall implement rating outlook/rating watch into their ratings monitoring framework, where applicable

(g) Human resources and expertise

- (i) A CRA shall have sufficient number of analysts who are qualified to carry out rating assignments and subsequent monitoring of the bonds. In this regard, the lead analyst shall have sufficient experience on credit assessment.
- (ii) In assessing the competence of its analysts, a CRA shall consider, among others, their level of education; experience within sectors, industries and geographic regions; experience with particular transactions and asset classes; and other specialty areas.

- (iii) A CRA shall ensure that its analysts maintain sufficient high level of analytical and monitoring rigour. In this regard, the applicant shall consider the number of bonds that can be effectively covered by a particular analyst, taking into account a broad spectrum of variables, including the size and complexity of the particular bond and the experience and expertise of the analyst.
- (iv) A CRA shall ensure that all staff involved in the rating and monitoring process are and remain qualified through adequate training. In this regard, it shall adopt policies and procedures designed to ensure that its analysts receive sufficient training and support to facilitate the generation of independent, objective and credible rating opinions.
- (v) A CRA shall provide adequate training for its analysts and notify the SC of the training programs and continuing professional education programs that its analysts attended at the end of each calendar year.

(h) Operational requirements

- (i) A CRA shall have adequate infrastructure to provide reliable bond rating services and maintain its credit rating operations and facilities with adequate security, system capacity and contingency arrangements.
- (ii) A CRA shall maintain internal records to support its credit opinions for a reasonable period of time or in accordance with applicable laws.

(i) Confidentiality of Information

- (i) A CRA and its staff shall maintain confidentiality of the information obtained from its clients in accordance with the confidentiality agreements entered into with its clients.
- (ii) A CRA shall establish, maintain and implement written policies, controls and procedures to prevent the misuse of non-public information and to determine if these procedures are followed.

(j) Fit and proper requirements

- (i) A CRA and every person who is, or is to be, a director, chief executive and key personnel of the applicant shall be fit and proper persons.
- (ii) In determining whether a person is fit and proper to hold the above position in a CRA, regard shall be had as to his probity, diligence, competence and soundness of judgment of fulfilling the responsibilities of that position, to whether the interest of customers, if any, of the applicant are likely to be in any way threatened by his holding that position as well as to the previous conduct and activities in business or financial matters of the person in question.

(k) Adoption of the International Organisation of Securities Commission's Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO CRA Code)

- (i) A CRA shall adopt the IOSCO CRA Code in its own code of conduct and disclose it on its website.
- (ii) Where the CRA's Code of Conduct differs in substance from the provision of the IOSCO CRA Code, the CRA shall explain where and why these differences exist, and fully disclose this on its website.

3.0 RECOGNITION PROCEDURE

- 3.1 In relation to an application to be recognised as a CRA, an applicant is required to submit the following information and documents in its application letter to the SC:
 - (a) corporate information and information pertaining to the operations of the CRA (as set out in Appendix 1); and
 - (b) Declaration letter (as set out in Appendix 2).
- 3.2 The SC may require the applicant to furnish such further information or clarification as the SC considers necessary, for the purpose of processing of the application.

4.0 CONTINUOUS COMPLIANCE AND REPORTING REQUIREMENTS

4.1 A CRA shall at all times undertake to comply with:

- (a) the requirements stipulated in this Note; and
- (b) any terms and conditions as may be specified by the SC.

4.2 A CRA shall submit to the SC:

- (a) its latest audited financial statements, as soon as reasonably possible but not more than six (6) months after the close of each financial year; and
- (b) any other relevant information or documents as may be required by the SC.

4.3 All submissions and correspondences with the SC should be addressed to:

Chairman
Securities Commission
3 Persiaran Bukit Kiara
Bukit Kiara
50490 Kuala Lumpur

(Attention : Director of Market Policy & Development Division)

APPLICATION FOR RECOGNITION OF CREDIT RATING AGENCY

1. Corporate Information

- (a) Name of company :
- (b) Date of incorporation :
- (c) Date of commencement of operations (if applicable) :
- (d) Company number :
- (e) Authorised Capital :
- (f) Paid-Up Capital :
- (g) Shareholders' funds :
- (h) Financial Year End :

2. Address and Contact Details

- (a) Registered Address :
- (b) Business Address :
- (c) Telephone Number :
- (d) Fax Number :
- (e) Website address :
- (f) Name and telephone number of contact person :

3. Shareholders (as at submission date)

Name of shareholder	Percentage of Shareholding
Total	

4. Directors

Name of Director	Status <i>(Please indicate independent or non-independent status as well Chairman of the Board. Also indicate if director has executive status)</i>

5. Senior Management and Analysts

Name of Personnel	Position	Qualification and Experience	Telephone number

6. Rating Committee

Name of Member	Position	Qualification and Experience	Telephone number

7. Financial Position

Summary of the applicant's past performance based on the last three financial years, where applicable (*please provide a copy of the latest audited financial statement*)

	As at [Date] RM '000	As at [Date] RM '000	As at [Date] RM '000
Turnover			
Pre-tax profit/loss			
After tax profit/loss			
Issued and paid-up capital			
Shareholders' funds			

8. Corporate organisational structure

9. A copy of its Code of Conduct and compliance with the IOSCO CRA Code

10. Details of rating methodologies and due process

11. Details of rating monitoring process

12. Any other relevant information to support the application

Appendix 2

Date: ...(Date of Application)...

The Chairman
Securities Commission

Dear Sir,

DECLARATION LETTER PURSUANT TO THE APPLICATION FOR RECOGNITION AS A CREDIT RATING AGENCY

We declare to the best of our knowledge that there is no false or misleading statement contained in, or material omission from, the information that is provided to the SC in relation to the above application.

We declare that we are satisfied after having made all reasonable enquiries that:

- (a) this application is in full compliance with the Practice Note on the Recognition of Credit Rating Agencies (Note); and
- (b) we have not been convicted or charged with any offence under the securities laws, corporation laws or other laws involving fraud or dishonesty in a court of law, for the last 10 years prior to this submission.

We declare that we will ensure continuous compliance with the requirements stipulated in the Note and to the terms and conditions as may be imposed by the SC in relation to the above application.

We undertake to provide to the SC all such information as the SC may require in relation to the application.

The above Declaration has been signed by me as ...(designation of director)... of the Applicant pursuant to the authority granted to me by a resolution of the Board of Directors on ...(date of resolution)...

Yours faithfully,

.....

Name:

Name of Applicant: