

July 6, 2016

Governments of:  
British Columbia,  
Saskatchewan,  
Ontario,  
New Brunswick,  
Prince Edward Island,  
Yukon and  
Canada

By Electronic Mail: [comment@ccmr-ocrmc.ca](mailto:comment@ccmr-ocrmc.ca)

**COMMENTS ON REVISED CONSULTATION DRAFT OF THE CAPITAL MARKETS STABILITY ACT (“REVISED DRAFT CMSA”)**

Moody's Canada Inc. (“Moody's”) wishes to thank the Governments of British Columbia, Saskatchewan, Ontario, New Brunswick, Prince Edward Island, Yukon and Canada (“Participating Jurisdictions”) for the opportunity to comment on the Revised Draft CMSA.

Moody's supports the Participating Jurisdictions' efforts to manage systemic risk in a manner that fosters sound, well-functioning capital markets in Canada. We also appreciate the Participating Jurisdictions' efforts to incorporate feedback from credit rating organizations (CROs) on the previous Consultation Draft CMSA.<sup>1</sup> In particular, Moody's notes the Revised Draft CMSA focuses on: (1) targeted management of systemic risks, and (2) regulatory coordination to avoid unnecessary duplication of existing regulatory frameworks. Consistent with these objectives, we request the Participating Jurisdictions refine Section 23 of the Revised Draft CMSA to specifically address risks associated with sole and mechanistic use of credit ratings, and to eliminate potential redundancies related to the management of potential conflicts of interest.

We discuss these concerns in more detail in the attached Annex I.

Yours sincerely,

**/S/ Hilary Parkes**

Hilary Parkes  
Senior Vice President

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<sup>1</sup> Moody's Canada submitted comments on the Draft Provincial Capital Markets Act and the Draft Capital Market Stability Act on December 3, 2014.

## I. The Revised Draft CMSA Should Address the Mechanistic Use of Credit Ratings

Moody's supports the Revised Draft CMSA's focus on systemically important products and systemically risky practices rather than entity-based assessments and designations. In order to bring Section 23(g) into alignment with international policy initiatives on the use of credit ratings, the section could be revised to specifically address "sole and mechanistic use of credit ratings" rather than the use of credit ratings generally.<sup>2</sup>

In October 2010, the Financial Stability Board issued Principles for Reducing Reliance on CRA Ratings ("FSB Principles").<sup>3</sup> The FSB Principles recognise that CROs play an important role in the capital markets and their ratings can appropriately be used as an input to a market participant's own judgement. The FSB Principles make clear, however, that market participants should not "rely solely or mechanistically on CRA ratings", and the use of credit ratings "does not lessen a market participant's responsibility to ensure that its credit exposures are based on sound assessments".<sup>4</sup>

The FSB Principles also call upon regulators and standard setters to consider steps towards reducing sole and mechanistic use of credit ratings. In accordance with the FSB Principles, the International Organization of Securities Commissions (IOSCO) has taken steps to address the mechanistic use of credit ratings by market participants,<sup>5</sup> as have a number of other international policymakers.<sup>6</sup>

In contrast to the FSB Principles, Section 23(g) of the Draft CMSA does not specifically address "sole or mechanistic use" of credit ratings, but instead suggests that any use of credit ratings could be determined to be systemically risky. As drafted, it would appear that Section 23(g) goes wider than international policy on the issue, and appears inconsistent with the objectives of the Revised Draft CMSA to manage specific practices that may pose a systemic risk to the Canadian capital markets. Therefore, we suggest that Section 23(g) be revised as follows:

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<sup>2</sup> Section 23(g) of the Revised Draft CMSA states that regulations may, in order to address a systemic risk related to capital markets, prescribe requirements, prohibitions and restrictions respecting practices that are prescribed to be systemically risky, including in relation to "the use of credit ratings, including how investment policies govern that use".

<sup>3</sup> Financial Stability Board, Principles on Reducing Reliance on CRA Ratings, 27 October 2010, pg.2 (available at [http://www.fsb.org/wp-content/uploads/r\\_101027.pdf](http://www.fsb.org/wp-content/uploads/r_101027.pdf)).

<sup>4</sup> *Id.*

<sup>5</sup> See *IOSCO Final Report - Good Practices on Reducing Reliance on CRAs in the Asset Management Industry* (June 2015) (available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD488.pdf>).

<sup>6</sup> For example, Article 5a of the EU Regulation on CRAs requires that market participants "make their own credit assessments" and not "solely or mechanistically rely on credit ratings for assessing the creditworthiness of an entity or financial instrument." Regulation (EC) No 1060/2009 of the European Parliament and of the Council as amended by Regulation (EU) No 513/2001 and Regulation (EU) No 462/2013 on credit rating agencies (21 May 2013). The EU Regulation on CRAs also restricts the European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB) from referring to credit ratings "where such references have the potential to trigger sole or mechanistic reliance on credit ratings". *Id.* at Article 5b. See also *Thematic Review on FSB Principles for Reducing Reliance on CRA Ratings – Peer Review Report* (May 12, 2014) (available at [http://www.fsb.org/wp-content/uploads/r\\_140512.pdf](http://www.fsb.org/wp-content/uploads/r_140512.pdf)).

23. The regulations may, in order to address a systemic risk related to capital markets, prescribe requirements, prohibitions and restrictions respecting practices that are prescribed to be systemically risky, including in relation to:

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- (g) the sole and mechanistic use of credit ratings, including how investment policies govern ~~that~~ such use.

## II. The Existing Regulatory Framework Addresses Potential Conflicts of Interest

Moody's welcomes regulatory coordination across jurisdictions, and we support efforts to avoid duplication of existing regulatory frameworks. We understand that the Revised Draft CMSA is intended to achieve both goals.<sup>7</sup> In support of these goals, we would suggest striking Section 23(h) of the Revised Draft CMSA as duplicative of existing CRO regulatory provisions in Canada and elsewhere relating to potential conflicts of interest.

Section 23(h) of the Revised CMSA provides authority for the Chief Regulator to prescribe requirements, prohibitions and restrictions respecting practices that are prescribed to be systemically risky, including in relation to "conflicts of interest related to the determination of credit ratings". The existing regulatory framework in Canada for CROs<sup>8</sup> includes a comprehensive set of provisions related to the management of potential conflicts of interest. In particular, Section 3 of NI-25-101 ("Independence and Conflicts of Interests") contains eighteen provisions designed to ensure that CROs avoid conflicts of interest in the rating process.<sup>9</sup>

It is difficult to envisage a scenario where regulations promulgated under Section 23(h) would not be duplicative, redundant or burdensome. In the absence of an identifiable gap in NI-25-101 related to conflicts of interest, we would encourage the Participating Jurisdictions to strike Section 23(h) from the Revised Draft CMSA.

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<sup>7</sup> "...the Authority must coordinate, to the extent practicable, its regulatory activities with those of other federal, provincial and foreign financial authorities so as to promote efficient capital markets, to achieve effective regulation and to avoid imposing an undue regulatory burden." Revised Draft CMSA, Section 6(2).

<sup>8</sup> CSA National Instrument 25-101 - Designated Rating Organizations, Related Policies and Consequential Amendments; proposed Capital Markets Act National Instrument 25-101.

<sup>9</sup> For example, provision 3.1 requires that CROs refrain from taking a rating action based in whole or in part on the potential effect of the action on the CRO a rated entity, an investor, or other market participant. Provision 3.5 requires that CRO keep separate, operationally and legally, their credit rating business from any other ancillary service that may create a conflict of interest. Provisions 3.7 and 3.8 require that CROs identify and eliminate or manage and publicly disclose any actual or potential conflicts of interest.