

**CSA Notice and Request for Comment  
Relating to Designated Rating Organizations**

**Proposed Amendments to  
National Instrument 25-101 *Designated Rating Organizations*,  
National Instrument 31-103 *Registration Requirements, Exemptions and  
Ongoing Registrant Obligations*,  
National Instrument 33-109 *Registration Information*,  
National Instrument 41-101 *General Prospectus Requirements*,  
National Instrument 44-101 *Short Form Prospectus Distributions*,  
National Instrument 44-102 *Shelf Distributions*,  
National Instrument 45-106 *Prospectus Exemptions*,  
National Instrument 51-102 *Continuous Disclosure Obligations*,  
National Instrument 81-102 *Investment Funds*  
and  
National Instrument 81-106 *Investment Fund Continuous Disclosure***

**and**

**Proposed Changes to  
Companion Policy 21-101CP *Marketplace Operation*  
and  
Companion Policy 81-102CP *Investment Funds***

**July 6, 2017**

**Introduction**

The Canadian Securities Administrators (the **CSA** or **we**) are publishing for a 90-day comment period proposed amendments (the **Proposed Amendments**) to:

- National Instrument 25-101 *Designated Rating Organizations* (**NI 25-101**),
- National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**),
- National Instrument 33-109 *Registration Information* (**NI 33-109**),
- National Instrument 41-101 *General Prospectus Requirements* (**NI 41-101**),
- National Instrument 44-101 *Short Form Prospectus Distributions* (**NI 44-101**),
- National Instrument 44-102 *Shelf Distributions* (**NI 44-102**),
- National Instrument 45-106 *Prospectus Exemptions* (**NI 45-106**),
- National Instrument 51-102 *Continuous Disclosure Obligations* (**NI 51-102**),
- National Instrument 81-102 *Investment Funds* (**NI 81-102**), and
- National Instrument 81-106 *Investment Fund Continuous Disclosure* (**NI 81-106**).

We are also publishing for a 90-day comment period proposed changes (the **Proposed Changes**) to:

- Companion Policy 21-101CP *Marketplace Operation (21-101CP)*, and
- Companion Policy 81-102CP *Investment Funds (81-102CP)*.

The Proposed Amendments and the Proposed Changes relate to designated rating organizations (**DROs**) and credit ratings of DROs.

The text of the Proposed Amendments and the Proposed Changes is contained in Annexes C to N of this notice and will also be available on websites of CSA jurisdictions, including:

www.lautorite.qc.ca  
www.albertasecurities.com  
www.bcsc.bc.ca  
nssc.novascotia.ca  
www.fcnc.ca  
www.osc.gov.on.ca  
www.sfsc.gov.sk.ca  
www.msc.gov.mb.ca

## **Substance and Purpose**

The Proposed Amendments and the Proposed Changes consist of the following:

### ***1. Proposed Amendments relating to EU equivalency and IOSCO Code revision***

We propose to amend NI 25-101 to reflect new requirements for credit rating organizations in the European Union (**EU**) that must be included in NI 25-101 by June 1, 2018 in order for:

- the EU to continue to recognize the Canadian regulatory regime as “equivalent” for regulatory purposes in the EU (**EU equivalency**), and
- credit ratings of a Canadian office of a DRO to continue to be used for regulatory purposes in the EU.

We also propose to amend NI 25-101 to reflect new provisions in the March 2015 version of the IOSCO *Code of Conduct Fundamentals for Credit Rating Agencies* (the **IOSCO Code**) of the International Organization of Securities Commissions (**IOSCO**). Since NI 25-101 is based on the previous version of the IOSCO Code, we want to continue to be able to represent that NI 25-101 reflects the IOSCO Code.

### ***2. Proposed Amendments and Proposed Changes relating to Kroll application for designation as a DRO and Other Matters***

As discussed in greater detail in the “Background” section of this notice, Kroll Bond Rating Agency, Inc. (**Kroll**) has filed an application for designation as a DRO.

We propose to amend NI 44-101 and NI 44-102 to recognize credit ratings of Kroll, but only for the purposes of the alternative eligibility criteria in section 2.6 of NI 44-101 and section 2.6 of NI 44-102 for issuers of asset-backed securities (**ABS**) to file a short form prospectus or shelf prospectus, respectively (the **ABS Short Form Eligibility Criteria**).

The Proposed Amendments and Proposed Changes also address the following matters (the **Other Matters**):

- To ensure that Kroll credit ratings are only recognized for purposes of the ABS Short Form Eligibility Criteria, we propose to include clarifying language in provisions of NI 31-103, NI 33-109, NI 41-101, NI 45-106, NI 81-102, NI 81-106 and 21-101CP that refer to DROs or credit ratings of DROs.
- We have included certain “housekeeping” revisions in the Proposed Amendments and the Proposed Changes.

## **Background**

### ***1. Proposed Amendments relating to EU equivalency and IOSCO Code revision***

#### ***EU equivalency***

We propose to amend NI 25-101 to reflect new EU requirements that must be included in NI 25-101 by June 1, 2018 in order to maintain EU equivalency.

The EU regulation on credit rating agencies (the **EU CRA Regulation**) allows credit ratings issued outside the EU to be used for regulatory purposes in the EU when they are issued by certified credit rating agencies or endorsed by credit rating agencies established in the EU. As the legal and supervisory framework for DROs in NI 25-101 has been deemed as stringent as the EU framework by the European Securities and Markets Authority (**ESMA**) and equivalent by the European Commission (**EC**) pursuant to an EC implementing decision of October 5, 2012, both mechanisms are currently operational in respect of credit ratings of a Canadian office of a DRO.

In 2013, the EU CRA Regulation was amended to include a range of new requirements. While some of these new requirements are explicitly excluded from the assessment of EU equivalency, ESMA and the EC are required to ensure that the remaining provisions are taken into account for their past EU equivalency decisions. The entry into force of these new requirements for the purposes of EU equivalency is June 1, 2018.

#### ***IOSCO Code revision***

We also propose to amend NI 25-101 to reflect new provisions in the IOSCO Code.

The IOSCO Code offers a set of robust measures as a framework for credit rating organizations to protect the integrity of the rating process, ensure that investors and issuers are treated fairly, and safeguard confidential material information provided to credit rating organizations by issuers. In March 2015, the IOSCO Code was revised to include new provisions.

Since NI 25-101 is based on the previous version of the IOSCO Code, we want to continue to be able to represent that NI 25-101 reflects the IOSCO Code.

### ***2. Proposed Amendments and Proposed Changes relating to Kroll application for designation as a DRO and Other Matters***

#### ***Kroll application***

Currently, there are four DROs in Canada: S&P Global Ratings Canada (**S&P**), Moody’s Canada Inc. (**Moody’s**), Fitch Ratings, Inc. (**Fitch**) and DBRS Limited (**DBRS**).

Kroll has filed an application for designation as a DRO. The Ontario Securities Commission (OSC) is the principal regulator for the Kroll application.

Kroll's application is significant and novel since it is the first designation application from a credit rating organization whose credit ratings have:

- not previously been referred to in CSA rules and policies, and
- not generally been used in the Canadian marketplace.

Kroll mainly operates in the United States, where it is registered as a “nationally recognized statistical rating organization” with the United States Securities and Exchange Commission.

### ***Regulatory approach to Kroll application***

Under applicable securities legislation, the OSC can only make a designation for the purpose of allowing an applicant credit rating organization (a **DRO Applicant**) to satisfy:

- a requirement in securities law that a credit rating be given by a DRO, or
- a condition for an exemption under securities law that a credit rating be given by a DRO, (collectively, **Credit Rating Provisions**).

The Credit Rating Provisions serve a “minimum standards” function by establishing minimum levels of credit quality of securities for certain regulatory purposes (e.g., the availability of an exemption or an alternative process in a rule). The Credit Rating Provisions currently refer to specific credit ratings of the four existing DROs. It is therefore appropriate for the principal regulator to consider whether a DRO Applicant's credit ratings can satisfy this minimum standards function for specific Credit Rating Provisions.

This requires the principal regulator to consider the following as part of its designation decision:

- whether the Applicant DRO has sufficient experience and expertise in rating the particular types of securities and issuers covered by specific Credit Rating Provisions; and
- the appropriate credit rating level for the specific Credit Rating Provisions.

As a result, the principal regulator should only make its final designation order in conjunction with appropriate rule and policy amendments being made to the relevant Credit Rating Provisions.

### ***Analysis of Kroll application***

Based on the information provided by Kroll, it appears that Kroll has sufficient expertise and experience in rating ABS for purposes of the ABS Short Form Eligibility Criteria. Consequently, subject to confirmation and completion of certain matters, staff anticipate recommending that Kroll be designated as a DRO, but only:

- for the purposes of the ABS Short Form Eligibility Criteria, and
- if the Proposed Rule Amendments and Policy Changes are enacted as final rule amendments and policy changes and those amendments and changes come into effect following Ministerial approval of the rule amendments.

At this time, staff do not anticipate recommending that Kroll be designated as a DRO for purposes of other Credit Rating Provisions.

***Appropriate rating categories of Kroll for ABS Short Form Eligibility Criteria***

Based on the information provided by Kroll, it appears that a Kroll long term credit rating of “BBB” and a Kroll short term credit rating of “K3” are the appropriate rating categories for purposes of the ABS Short Form Eligibility Criteria.

- Under the ABS Short Form Eligibility Criteria, an ABS issuer must have a “designated rating” from a DRO, which would include a long term credit rating at or above “BBB” (for DBRS, Fitch and S&P) or “Baa” (for Moody’s).
- As part of its work in determining the appropriate rating categories of Kroll, staff compared a large number of credit ratings of Kroll for numerous ABS issuers in the United States against those of DBRS, Fitch, S&P and Moody’s for the same issuers. This work allowed staff to consider whether Kroll regularly gave higher or lower credit ratings than its competitors.
- Staff considered the experience of Kroll in rating ABS issuers in the United States to be relevant in determining the appropriate rating categories of Kroll for purposes of the ABS Short Form Eligibility Criteria.

**Summary of the Proposed Amendments and Proposed Changes**

***1. Proposed Amendments relating to EU equivalency and IOSCO Code revision***

Annex A sets out a summary of the Proposed Amendments relating to EU equivalency and the IOSCO Code revision.

***2. Proposed Amendments and Proposed Changes relating to Kroll application for designation as a DRO and Other Matters***

Annex B sets out a summary of the Proposed Amendments and Proposed Changes relating to the Kroll application for designation as a DRO and the Other Matters.

**Impact on Investors**

***1. Proposed Amendments relating to EU equivalency and IOSCO Code revision***

If the Proposed Amendments relating to EU equivalency and the IOSCO Code revision are enacted, investors may benefit from the additional safeguards in NI 25-101 that DROs will be required to follow. In particular, the Proposed Amendments will provide additional safeguards for protecting the integrity of the rating process, ensuring that investors and issuers are treated fairly, and safeguarding confidential material information provided to DROs by issuers.

***2. Proposed Amendments and Proposed Changes relating to Kroll application for designation as a DRO and Other Matters***

If the Proposed Amendments and Proposed Changes relating to the Kroll application for designation as a DRO are enacted and Kroll is designated as a DRO for purposes of the ABS Short Form Eligibility Criteria, Kroll may increase its presence in the Canadian marketplace and more investors in Canada may use Kroll’s credit ratings.

The Proposed Amendments and Proposed Changes do not detract from (or contradict) past CSA efforts to help ensure that investors are cautioned about undue mechanistic reliance on credit ratings and the limits of credit ratings. In particular, under existing prospectus and continuous disclosure rules, reporting issuers are required to provide disclosure (including cautionary statements) about the attributes and limitations of their credit ratings.

## **Anticipated Costs and Benefits**

### ***1. Proposed Amendments relating to EU equivalency and IOSCO Code revision***

The benefits of the Proposed Amendments relating to EU equivalency and the IOSCO Code revision include the following:

- Issuers and investors may benefit from the additional safeguards in NI 25-101 that DROs will be required to follow. In particular, the Proposed Amendments will provide additional safeguards for protecting the integrity of the rating process, ensuring that investors and issuers are treated fairly, and safeguarding confidential material information provided to DROs by issuers.
- DROs, issuers and investment dealers will benefit if EU equivalency is maintained so that credit ratings of a Canadian office of a DRO can continue to be used for regulatory purposes in the EU. Continued EU equivalency is important for Canadian issuers that pay for such a credit rating and sell their rated securities to EU investors, investment dealers that structure cross-border transactions involving rated securities of Canadian issuers on the basis of EU equivalency, and institutional investors that use such a credit rating for regulatory purposes in the EU.

DROs will incur costs associated with understanding and complying with the new requirements.

One-time start-up costs include:

- a DRO revising its code of conduct to comply with the new requirements in Appendix A of NI 25-101;
- a DRO revising its existing policies and procedures, or developing new policies and procedures, to comply with the new requirements.

However, we understand that:

- certain DROs have already revised their codes of conduct, revised existing policies and procedures and developed new policies and procedures to comply with new provisions in the March 2015 version of the IOSCO Code; and
- certain DROs, or their DRO affiliates that operate in the EU, have policies and procedures that comply with the new EU requirements.

### ***2. Proposed Amendments and Proposed Changes relating to Kroll application for designation as a DRO and Other Matters***

In terms of potential benefits to Kroll and other market participants, if the Proposed Amendments and Proposed Changes relating to the Kroll application for designation as a DRO come into effect and Kroll is designated as a DRO for purposes of the ABS Short Form Eligibility Criteria:

- More ABS issuers may retain Kroll to rate their ABS.

- Issuers, investment dealers and institutional investors may have an increased choice of DROs and competition among DROs may increase.

Market participants will need to understand and comply with the new provisions.

“Rating shopping” may occur if an issuer seeks to retain those credit rating organizations that are more likely to provide the most favourable credit ratings of the issuer and its securities. There may be an increased potential for rating shopping by ABS issuers from the Proposed Amendments.

### **Local Matters**

Where applicable, Annex P provides additional information required by the local securities legislation.

### **Request for Comments**

We welcome your comments on the Proposed Amendments and the Proposed Changes. In addition to any general comments you may have, we also invite comments on the following specific questions:

1. Do you agree that a Kroll long term credit rating of “BBB” and a Kroll short term credit rating of “K3” would be the appropriate rating categories for purposes of the ABS Short Form Eligibility Criteria?
2. We have considered the experience of Kroll in rating ABS issuers in the United States in determining the appropriate rating categories of Kroll for purposes of the ABS Short Form Eligibility Criteria. Do you agree that this U.S. experience is relevant to the Canadian marketplace?
3. Do you think there is an increased potential for rating shopping by ABS issuers if the Proposed Amendments are implemented? If so, why or why is that a concern?
4. What would be the implications to Canadian market participants if the EU did not continue to recognize the Canadian regulatory regime in NI 25-101 as “equivalent” for regulatory purposes in the EU? We are interested in details of how you would be impacted.

### **How to Provide Comments**

Please submit your comments in writing on or before **October 4, 2017**. If you are not sending your comments by email, an electronic file containing the submissions should also be provided (in Microsoft Word format).

Address your submission to all of the CSA as follows:

British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan

Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
Financial and Consumer Services Commission (New Brunswick)  
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Nunavut

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA.

The Secretary  
Ontario Securities Commission  
20 Queen Street West, 22<sup>nd</sup> Floor  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
comment@osc.gov.on.ca

Me Anne-Marie Beaudoin  
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consultation-en-cours@lautorite.qc.ca

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of the written comments received during the comment period. All comments received will be posted on the websites of each of the Alberta Securities Commission at [www.albertasecurities.com](http://www.albertasecurities.com), the Autorité des marchés financiers at [www.lautorite.qc.ca](http://www.lautorite.qc.ca) and the Ontario Securities Commission at [www.osc.gov.on.ca](http://www.osc.gov.on.ca). Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

### **Contents of Annexes**

This notice includes the following annexes:

- Annex A sets out a summary of the Proposed Amendments relating to EU equivalency and the IOSCO Code revision,
- Annex B sets out a summary of the Proposed Amendments and Proposed Changes relating to the Kroll application for designation as a DRO and the Other Matters,
- Annex C sets out the Proposed Amendments to NI 25-101,
- Annex D sets out the Proposed Amendments to NI 31-103,



- Annex E sets out the Proposed Amendments to NI 33-109,
- Annex F sets out the Proposed Amendments to NI 41-101,
- Annex G sets out the Proposed Amendments to NI 44-101,
- Annex H sets out the Proposed Amendments to NI 44-102,
- Annex I sets out the Proposed Amendments to NI 45-106,
- Annex J sets out the Proposed Amendments to NI 51-102,
- Annex K sets out the Proposed Amendments to NI 81-102,
- Annex L sets out the Proposed Amendments to NI 81-106,
- Annex M sets out the Proposed Change to 21-101CP, and
- Annex N sets out the Proposed Change to 81-102CP.

Certain jurisdictions may set out, in Annex O, a full text version of NI 25-101 that includes the Proposed Amendments, blacklined to show the changes from the current version of NI 25-101.

Where applicable, Annex P provides additional information relevant for local jurisdictions.

## **Questions**

Please refer your questions to any of the following:

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