

**[ SEC MEMORANDUM CIRCULAR NO. 7, March 06, 2014 ]**

**GUIDELINES ON THE ACCREDITATION, OPERATIONS AND REPORTING OF CREDIT RATING AGENCIES**

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To increase transparency and improve the integrity of credit ratings, the Commission resolved to issue this Circular amending the relevant provisions of Securities Regulation Code (SRC) Rule 12 on accreditation by the Commission of credit rating agencies (CRAs).

**1. Applicability**

- A. These Guidelines shall apply to CRAs that are engaged by corporations which offer or issue commercial papers or debt securities to the public, except for issuance amounting to not more than twenty five per cent (25%) of the issuer's net worth or where there is an irrevocable committed credit line with a bank covering one hundred per cent (100%) of the proposed issuance.
- B. For purposes of these Guidelines, a CRA means any corporation principally and regularly engaged in the business of performing credit evaluation of corporations and business projects or of debt issues with the intention of assessing the overall creditworthiness or of ascertaining the willingness and ability of the issuer to pay its financial obligations as they fall due, and which assessment is translated by credit ratings periodically and publicly announced.

**2. Scope and Limitations**

- A. The accreditation of a CRA does not relieve it from its liabilities and responsibilities.
- B. The Commission shall not be liable for any liability or loss that may arise from the selection of the said CRA by any issuer.
- C. The accreditation of a CRA shall continue until suspended or revoked by the Commission after due notice and hearing.
- D. No person or entity shall, under pain of sanctions under the Code, hold itself out as an accredited CRA or otherwise regulated in providing credit rating services unless it has been accredited by this Commission under these Guidelines.

**3. Requirements for Accreditation**

- A. To qualify for accreditation, a CRA shall submit proof of compliance with the following requirements:

- (i) The CRA must be a stock corporation;
- (ii) It has a paid-up capital of at least Ten Million Pesos (P10,000,000.00);
- (iii) It has at least five (5) years operating experience as a CRA;
- (iv) It has qualified and independent officers and personnel to conduct the rating activities;
- (v) It has no conflict of interest with prospective clients;

B. The CRA must submit among others, the following supporting documents:

- (i) List of shareholders and their corporate affiliations;
- (ii) List of other business activities, if any;
- (iii) Copies of the company's Articles of incorporation and By-Laws;
- (iv) A statement pertaining to ownership structure and possible conflict/s of interest;
- (v) Names, professional qualification and independence of staff involved in the rating decision ("rating specialists");
- (vi) A written code of conduct which insures the independence of the rating specialists and the rating agency from the issuers it is rating;
- (vii) Disclosure of affiliations, training, assistance or support it receives from international rating agencies, if any;
- (viii) Rating scales, criteria, measurements, symbols and the like, which it has in use;
- (ix) Operating procedures, rating policies, rating criteria and other rationale used in arriving at a rating;
- (x) Copy of model written agreement with issuers; and
- (xi) Manual on Corporate Governance. An applicant may request confidentiality of the foregoing information except its operating procedures, rating policies and rating criteria.

E. All applications for accreditation shall be accompanied by an initial filing fee of Sixty Thousand Pesos (P60,000.00) or such amount as the Commission may determine through its Scale of Fees and Charges.

F. All accredited credit rating agencies shall ensure that the information set forth in their application form and all documents appended thereto are current, true and correct. Any change in such information shall be filed with the Commission no later than ten (10) business days from the occurrence of such change.

G. An annual fee of Twelve Thousand Pesos (P12,000.00) or such amount as the Commission may determine, shall be paid yearly at least forty five (45) days prior to the anniversary date of the CRA's accreditation. If such annual fee is not paid, the registration of the CRA shall be suspended until payment is made, provided that if the same is not paid prior to the thirtieth (30th) day after the required payment date, such

accreditation shall be automatically terminated and any issuer which has been rated by such rating agency shall be required to obtain a new credit rating within thirty (30) days after notification by such agency of such termination.

#### 4. Operating Requirements

The following best practices<sup>[1]</sup> are hereby adopted as part of these Guidelines and must be observed by a CRA accredited by the Commission:

##### A. Pre-Rating Requirements

- (i) **A CRA and the entity it proposes to rate must sign a written contract, covering the CRA's obligation to render credit rating services.** This contract will list all CRA obligations included in the provision of credit opinion, the main service. A written contract enables the rated entity to better understand a CRA's deliverables, and is in line with high standards of ethical conduct. A well-drafted contract will avoid any disparity between a CRA and the rated entity regarding the responsibilities and obligations of each party, and will forge a formal legal relationship between the two. In the contract, the obligations of the rated entity for cooperation and provision of updated information to conduct periodic surveillance shall be clearly spelled out and the rights of the rated entity over the use of ratings clearly communicated. Conditions for contract termination, including withdrawal of assigned ratings, shall also be clearly spelled out.

This contract shall also be the underlying legal document for arbitration between a CRA and the entity, shall the need arise. Each CRA shall have a standardized version of such a document for each type of rating, and use it consistently.

- (ii) **A CRA shall not promise, assure, or guarantee a particular rating outcome – either implicitly or explicitly – while soliciting business.** Considering that ratings shall be based on an analytical decision by a rating committee and not the subjective view of an individual, no rating outcome shall be promised or committed either implicitly or explicitly to the rated entity and/or the arranger while soliciting business. No employee with business development responsibility or any other representative of the CRA shall be allowed to promise, assure, or guarantee – either implicitly or explicitly – a particular rating outcome. Any employee who does shall face disciplinary proceedings, including possible dismissal.

CRA's shall provide objective and fair credit opinions for use by debt market investors. The assignment of a rating shall therefore be derived purely from independent and unbiased views based on the determinants of credit quality and not on any assurance or guarantee given beforehand.

- (iii) **Rating definitions, policy for use, and rating criteria shall be explained to the rated entity before rating services are engaged.** A CRA shall explain to an entity that is being rated the

scope and use of the ratings, as well as the broad credit assessment framework followed. This shall be done before or at the time the CRA is engaged to enable the entity to make an informed decision about that engagement. This shall be communicated using standard presentations, brochures, and other materials, and disclosed on the CRA's website to minimize misinterpretation.

A CRA shall clearly communicate the rating definition and the rating scale. It shall also make clear that the ratings do not constitute recommendations to buy, hold, or sell any security, and shall inform the entity how to use the rating. Policies for use of ratings, conditions for withdrawal, and possible circumstances for rating actions shall also be clearly communicated.

- (iv) The basic policies, practices, and methodologies used for assignment of ratings shall be published and freely available in print and on the website.** Each CRA shall make a well-defined rating policy and rating methodology freely available to entities being rated, investors, market intermediaries, regulators, and other interested parties. Such disclosure shall help develop – among investors and issuers – an understanding of the credit risk assessment framework and related policies and practices.

A CRA's policy for assigning, revising, and withdrawing ratings shall be clearly outlined and made public. The validity of the rating shall be stated up front. A CRA shall institute a policy of not withdrawing any rating until the instrument that is rated has been redeemed in full; this shall allow the agency to fulfill its role of communicating the credit quality of the rated instrument at all times to investors.

No ratings shall be withdrawn until redemption of a rated instrument except when the CRA requests the Commission to withdraw ratings and the same is approved due to local market conditions and CRA's publication of a notice to the market about the withdrawal, the reason for it, and the rating outstanding on the instrument as of the date prior to withdrawal. Depending on the reason of withdrawal, the Commission may require the CRA to keep its rating on "notice of withdrawal" for some pre-specified period, and withdraw the rating once this period has expired. Accredited CRAs shall publish their withdrawal policies and ensure strict compliance with disclosed policies.

- (v) Adequate resources shall be made available.** A CRA must devote sufficient resources to ensure the high analytical quality of all its credit risk assessments. These resources shall include personnel with adequate skills, and facilities such as access to required information and tools and software to analyze information. Moreover, a CRA shall invest regularly in personnel training.

A CRA shall allocate financial resources for business development functions, outreach activities, and surveillance processes.

In addition to its initial capital stock a CRA shall build up its resources by increasing its paid-up capital to at least P15 Million after three (3) years reckoned from the date of its accreditation or from the effectivity of this Circular for those already accredited. After said period, the Commission may prescribe additional capital taking into account the volume of rating activities of the accredited CRA.

- (vi) The organizational structure and design of the rating process shall ensure that rating decisions are not influenced by rating fees, any other revenues or business potential from the rated entity, or the consequences of a rating action.**

The rating process must ensure that the final rating assigned is not influenced by the amount of rating fees received from the rated entity. A CRA shall publicly disclose its broad fee structure, including the minimum and maximum rating fees charged for any issue or issuer.

Personnel with business development responsibility shall be separate from those with analytical responsibility to ensure that business pressures do not influence ratings assigned. Compensation of CRA's rating analysts shall be independent of rating fees and the final rating assigned. Analytical staff and rating committee members shall not know the rating fee charged for the specific issues that they rate. The business relationship of an entity with a CRA shall in no way influence the process of assigning a rating to that entity or any of its group entities. Business relationships shall be kept completely isolated from the analytical process. All CRAs shall remove employees with business development responsibility from the analytical process to prevent influence of the business development viewpoint on the credit risk assessment.

If complete segregation of responsibilities between business development and analytical process is not doable considering the size and structure of the company, sufficient measures shall be established to eliminate or reduce the threat of influence of fees over the process of assigning ratings. These measures shall be clearly provided in the CRA's manual of operation.

## **B. Rating Definitions and Recognition of Default**

- (i) A CRA shall disclose whether its ratings indicate the probability of default on the rated instrument, issuer, or expected loss** (which factors in recoveries post-default). Ratings shall indicate either probability of default or expected loss. A CRA shall adopt the probability of default approach for ease of operation and due to the lack of data and experience in assessing recoveries after default in most economies in the region. The rating communication and all communications in relation to rating symbols shall clearly state what the particular rating indicates.
- (ii) A missed payment on a debt obligation on a due date or after a prespecified grace period (if any) shall constitute**