

**CSA Notice of Amendments
Relating to Designated Rating Organizations**

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

March 29, 2018

Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are making amendments (the **Amendments**) to:

- 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 making changes (the **Changes**) to:

- Companion Policy 21-101CP *Marketplace Operation* (**21-101CP**), and

- Companion Policy 81-102CP *Investment Funds (81-102CP)*.

The Amendments and the Changes relate to designated rating organizations (**DROs**) and credit ratings of DROs. The text of the Amendments and the Changes is contained in Annexes C to M of this notice.

The Amendments and the Changes are expected to be made by each member of the CSA. In some jurisdictions, Ministerial approvals are required for the Amendments. Provided all necessary ministerial approvals are obtained, the Amendments and the Changes are effective on June 12, 2018. Where applicable, Annex N provides information about each jurisdiction's approval process.

Substance and Purpose

The Amendments and the Changes relate to an application by Kroll Bond Rating Agency, Inc. (**Kroll**) for designation as a DRO.

We are amending 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 Amendments and 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 included 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 included certain "housekeeping" revisions in the Amendments and the Changes.

Background

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 mainly operates in the United States.

Subject to confirmation and completion of certain matters by Kroll, staff are recommending that Kroll be designated as a DRO, but only for purposes of the ABS Short Form Eligibility Criteria. We are making the Amendments and Changes so that Kroll credit ratings are only recognized for purposes of the ABS Short Form Eligibility Criteria.

See Annex A for further background on, and explanation of, the Amendments and Changes relating to the Kroll application for designation as a DRO.

Summary of Written Comments Received by the CSA

On July 6, 2017, we published a Notice and Request for Comment relating to the Amendments and the Changes (the **July 2017 Materials**). The comment period for the July 2017 Materials ended on October 4, 2017. We received written submissions from one commenter. We have considered the comments received and thank the commenter for their input. The name of the commenter is contained in Annex B of this notice and a summary of their comments, together with our responses, are contained in Annex B of this notice. The comment letter can be viewed on the websites of each of:

- the Alberta Securities Commission at www.albertasecurities.com,
- the Autorité des marchés financiers at www.lautorite.qc.ca, and
- the Ontario Securities Commission at www.osc.gov.on.ca.

Summary of Changes

We revised the July 2017 Materials in relation to the Amendments and the Changes to include references to successor credit rating organizations if designated under securities legislation. These revisions will allow for future reorganizations of DROs without having to effect further rule and policy amendments. The revisions are reflected in the Amendments and the Changes we are publishing concurrently with this notice. As these changes are not material, we are not republishing the Amendments and the Changes for a further comment period.

Update on proposed amendments to National Instrument 25-101

The July 2017 materials also included proposed amendments to National Instrument 25-101 *Designated Rating Organizations* (**NI 25-101**). We are still considering the proposed amendments to NI 25-101 as a result of the written submissions we received from four commenters, including three existing DROs.

The proposed amendments to NI 25-101 were intended to reflect new requirements for credit rating organizations (**CROs**) 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 certain regulatory purposes in the EU (**EU equivalency**), and
- credit ratings of a Canadian office of a DRO to continue to be available for use for certain regulatory purposes in the EU.

The proposed amendments to NI 25-101 were also intended to reflect new provisions in the March 2015 version of the Code of Conduct Fundamentals for Credit Rating Agencies of the International Organization of Securities Commissions.

Recent EU developments

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 either:

- “endorsed” by CROs established in the EU, or
- issued by “certified” CROs.

After the end of the comment period for the July 2017 Materials, on November 17, 2017, the European Securities and Markets Authority (**ESMA**) published final technical guidance on the application of the EU's methodological framework for assessing third country legal and supervisory frameworks for purposes of the EU endorsement regime and the EU equivalence/certification regime (the **Fall 2017 ESMA Publications**).

- In the Fall 2017 ESMA Publications, ESMA indicated that ESMA is now of the view that it is less onerous for a third country's regulatory regime for CROs to meet the requirements for the EU endorsement regime than the EU equivalence/certification regime.
- This represents a change in ESMA's approach to EU equivalency matters under the EU CRA Regulation.
- We have asked ESMA for a formal decision that the current version of NI 25-101 is sufficient for the Canadian regime for DROs to continue to be recognized for the EU endorsement regime after the EU equivalency deadline of June 1, 2018.
- Since the existing DROs in Canada are only relying on the EU endorsement regime, such a formal decision would mean that the CSA would not have to finalize the proposed amendments to NI 25-101 before the EU equivalency deadline of June 1, 2018.
- Consequently, we plan to delay the proposed amendments to NI 25-101 until a later date in 2018. Those amendments would be required in order for the Canadian regime for DROs to be recognized for the EU equivalence/certification regime. Since the existing DROs in Canada are not relying on the EU equivalence/certification regime, there is no urgency to finalize the proposed amendments to NI 25-101 before the EU equivalency deadline of June 1, 2018.

Contents of Annexes

This notice includes the following annexes:

- Annex A sets out background on the Amendments and Changes relating to the Kroll application for designation as a DRO,
- Annex B sets out the name of the commenter and a summary of their comments, together with our responses,
- Annex C sets out the Amendments to NI 31-103,
- Annex D sets out the Amendments to NI 33-109,
- Annex E sets out the Amendments to NI 41-101,
- Annex F sets out the Amendments to NI 44-101,
- Annex G sets out the Amendments to NI 44-102,
- Annex H sets out the Amendments to NI 45-106,
- Annex I sets out the Amendments to NI 51-102,
- Annex J sets out the Amendments to NI 81-102,
- Annex K sets out the Amendments to NI 81-106,
- Annex L sets out the Change to 21-101CP, and
- Annex M sets out the Change to 81-102CP.

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

Questions

Please refer your questions to any of the following:

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Annex A

Background on Amendments and Changes Relating to Kroll Application for Designation as a DRO

Kroll application

Kroll has filed an application for designation as a DRO. The 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 DRO Applicant 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
- following Ministerial approval of the 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.

Annex B

Summary of Comments and CSA Responses

We received written submissions from one commenter (The Canadian Advocacy Council for Canadian CFA Institute Societies) on the Amendments and the Changes.

No.	Subject	Summarized Comment	CSA Response
Specific questions relating to Kroll application for designation as a DRO			
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?	<p>The commenter submitted that:</p> <ul style="list-style-type: none"> • The ratings grid relating to the proposed amendments to the definition of “designated rating” in section 1.1 of NI 44-101 seems to imply that a credit rating from one of the DROs is equivalent to the same credit rating from Kroll. • Nonetheless, we do not have sufficient information with respect to the assumptions used by Kroll and the DROs in their rating methodologies for ABS to comment as to whether a Kroll long term rating of “BBB” and a Kroll short term rating of “K3” is equivalent to the credit ratings from the existing DROs. • However, based on its certifications, standards, experience with ABS and its transparency (for example, it makes available on its web site the methodologies and framework used for rating ABS securities), Kroll would appear to be an appropriate choice to rate ABS in Canada. 	<p>We thank the commenter for their input.</p> <p>As noted in the July 2017 Materials,</p> <ul style="list-style-type: none"> • 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

No.	Subject	Summarized Comment	CSA Response
			<p>and Moody's for the same issuers. This work allowed staff to consider if Kroll regularly gave higher or lower credit ratings than its competitors.</p> <ul style="list-style-type: none"> • 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.
2	<p>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?</p>	<p>The commenter submitted that Kroll's experience in the U.S. is relevant in the Canadian marketplace, especially since the market for ABS securities in the U.S. (particularly residential mortgage backed securities and commercial mortgage backed securities) experienced a more severe turmoil in the financial crisis than its Canadian counterpart (save for the asset-backed commercial paper sub-market).</p>	<p>We thank the commenter for their input.</p>
3	<p>Do you think there is an increased potential for rating shopping by ABS issuers if the Proposed Amendments are implemented? If so,</p>	<p>The commenter does not think there is an increased potential for rating shopping by ABS issuers. On the contrary, the commenter submitted that if Kroll is designated as a DRO, it will offer Canadian investors an additional and alternative credit perspective on ABS securities.</p> <p>The commenter also submitted that:</p> <ul style="list-style-type: none"> • The commenter released a survey of its members in the Americas region 	<p>We thank the commenter for their input.</p> <p>At this time, we do not propose to introduce requirements similar to those in SEC Rule 17g-5.</p>

No.	Subject	Summarized Comment	CSA Response
	why or why is that a concern?	<p>with a primary investment practice of fixed income in June 2014, which indicated that 24% of its members believe that removing regulatory requirements for financial firms to rely on ratings altogether would have the biggest positive impact on the reliability of credit ratings.</p> <ul style="list-style-type: none"> • In addition, 11% of its members believed that new entrants in the market had the biggest positive impact on the reliability of credit ratings. • Approximately 60% of participants in the survey indicated that all rating agency models have conflicts of interest (resulting in part from the issuer-pay model), and that increased transparency and competition would be the best solution. <p>The commenter noted that:</p> <ul style="list-style-type: none"> • In the U.S., SEC Rule 17g-5 requires NRSROs and certain “arrangers”, including issuers of structured finance products, to disclose to other rating organizations that the arranger is in the process of determining an initial credit rating, and each arranger must make the same information provided to the credit rating organization it hired available to the other rating organizations. • The SEC rule is intended in part to deal with the issue of rate shopping. • More prescriptive disclosure with respect to ratings under consideration, similar to what is specifically mandated by the SEC rule, could assist with additional transparency to the marketplace. 	