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October 20, 2010

To: Members of the Canadian Securities Administrators (the CSA)
British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
New Brunswick Securities Commission
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

Via email to:
jstevenson@osc.gov.on.ca
consultation-en-cours@lautorite.qc.ca

Re: Proposed National Instrument 25-101 Designated Rating Organizations (the Proposed Instrument), Related Policies and Consequential Amendments (collectively referred to as the Proposed Materials)[1]

Dear CSA:

DBRS[2] appreciates the opportunity to comment on the Proposed Materials.

[1] Includes the following, collectively referred to as the Proposed Materials:

- National Instrument 25-101 *Designated Rating Organizations* (the Proposed Instrument),
- Companion Policy 25-101CP to National Instrument 25-101 *Designated Rating Organizations* (the Proposed Companion Policy),
- Consequential amendments to National Instrument 41-101 *General Prospectus Requirements*,
- Consequential amendments to National Instrument 44-101 *Short Form Prospectus Distributions*
- Consequential amendments to National Instrument 51-102 *Continuous Disclosure Obligations*
- National Policy 11-205 Process for Designation as a Designated Rating Organization in Multiple Jurisdictions (the Proposed NP 11-205).

[2] DBRS operates its ratings business through DBRS Limited, DBRS, Inc. and DBRS Ratings Limited.

DBRS is Canada's leading credit rating agency with headquarters in Toronto, and offices in Chicago, London and New York. DBRS' credit ratings, research and financial analysis help investors make informed financial decisions. In Canada, DBRS has a role that is of particular significance, with comprehensive ratings coverage for all provinces, virtually all corporate entities, major banks and insurance companies, and asset-backed securities. DBRS is the primary rating agency for term securities, commercial paper, and preferred shares, and is the only credit rating agency that focuses on emerging Canadian companies. As the only Canadian based credit rating agency, DBRS believes it plays a unique and critical role in the Canadian capital market.

General Comments

Substance and purpose of the Proposed Instrument

At present, credit rating agencies or credit rating organizations (CROs) are not subject to formal securities regulatory oversight in Canada. The CSA proposes to develop and implement a securities regulatory regime for CROs that wish to have their credit ratings eligible for use in places where credit ratings are referred to in Canadian securities legislation that is consistent with international standards and developments.

The CSA has recognized that CROs have a significant impact upon financial markets and play a critical role in the capital markets.

DBRS believes credit ratings continue to be important to bondholders and other capital market participants. Ratings provide a useful and supplementary risk metric and information tool for investors in their decision-making, notably in the absence of viable, tested alternatives.[3] The December 2009 Basel Committee on Banking Supervision (BCBS) public consultation paper on strengthening the resilience of the banking sector[4] (Basel bank sector proposals) recognized that using credit ratings for capital purposes provide "a relatively standardized, harmonized, easy to understand, independent (third party) measure that generally reflects the credit quality of a counterparty, issuer or investment product." The Basel bank sector proposals also stated "that removal of external ratings from the Basel II framework could raise additional issues for determining regulatory capital requirements."

DBRS understands that international regulators and policy makers are looking at ways to reduce the overly mechanistic reliance on ratings. DBRS would agree that such reliance on ratings is inappropriate. Indeed, market participants should be encouraged to do their own homework and use ratings as one means of measuring credit quality.

With this in mind, DBRS agrees that CROs should be subject to formal regulatory oversight in Canada. Where formal regulation has been established, DBRS believes that it is not inconsistent for ratings to be referenced in securities legislation and in other policy documents[5]. As a global CRO, DBRS is regulated in other jurisdictions such as the U.S.

[3] As an example alternate model, having asset managers assign credit ratings, credit quality standards or expected losses would merely shift the accountability to an unregulated entity, which may also have a conflict of interest.

[4] See DBRS Comments on Basel Committee Banking Sector Proposals dated April 15, 2010.

[5] The Bank of Canada's Standing Liquidity Facility (SLF) includes credit-rating requirements for assets acceptable as collateral. DBRS' credit ratings are cited as eligible for collateral purposes.

[6]and in the European Union[7]. DBRS believes that a transparent regulatory framework serves to drive commitment to high standards, facilitates ongoing regulatory dialogue and supports investor and market education.

As a global CRO whose ratings are used internationally, DBRS believes that regulation should be internationally harmonized based on a common set of principles that promote a high degree of transparency and disclosure, analytical independence and integrity and objectivity of the ratings process. Regulation should also reflect the unique nature of each jurisdiction. Regulation that is internationally consistent and reflects the local market environment are not mutually exclusive concepts. DBRS suggests that regulation in one jurisdiction does not have to be exactly the same in another jurisdiction. This is particularly important in Canada where DBRS is the only Canadian-based global credit rating agency. What is critical to international harmonization is the development and adherence to a common set of principles that permits constructive interpretation of individual regulatory frameworks.

On the whole, DBRS believes that the CSA's Proposed Materials set the appropriate groundwork for regulating CROs within Canada.

The Proposed Instrument

The Proposed Instrument stems from an initial consultation paper entitled *Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil and its Effect on the ABCP Market in Canada* (the Consultation Paper). The Consultation Paper proposed to establish a regulatory framework that would require adherence to the "comply or explain" provision of the IOSCO *Code of Conduct Fundamentals for Credit Rating Agencies* (the IOSCO Code)[8] which remains the central requirement of the Proposed Instrument. DBRS provided comments on the Consultation Paper.[9]

Under the Proposed Instrument, a CRO can apply to be designated as a Designated Rating Organization (DRO). Once designated, the DRO must establish, maintain and ensure compliance with a code of conduct that is on terms substantially the same as the IOSCO Code. The DRO will only be permitted to deviate from the specific requirements of the IOSCO Code if it explains the deviation and indicates how its code nonetheless achieves the objectives of the IOSCO Code ("comply or explain"). The Proposed Instrument cites particular IOSCO Code provisions such as:

- CRO conflicts of interest (Part 2)
- misunderstandings by investors about what ratings mean (section 3.5)
- adequate staffing of CROs (sections 1.7 and 1.9)

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[6] DBRS is registered with the U.S. Securities and Exchange Commission (SEC) as a Nationally Recognized Statistical Rating Organization (NRSRO) pursuant to the *Credit Rating Agency Reform Act of 2006* (CRA Reform Act) and the rules adopted thereunder. Prior to the implementation of the CRA Reform Act, DBRS was designated as an NRSRO by the staff of the SEC's Division of Market Regulation.

[7] Regulation (EC) No 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies came into effect in December 2009 (EU CRA Regulation). As an existing CRO with regulatory recognition as an external credit assessment institution (ECAI), DBRS was required to apply for registration under the EU CRA Regulation by September 7, 2010.

[8] The most recent version of the IOSCO Code can be found at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf.

[9] See DBRS Response to the CSA Consultation Paper 11- 405 dated February 17, 2009.

- the quality of information used in making rating decisions (section 1.7)
- the ability to rate novel products (sections 1.7-1 and 1.7-3)
- the differentiation of ratings for different securities (section 3.5(b)), and
- the provision of public disclosure of historical information about the performance of ratings (section 3.8).

In addition, the Proposed Instrument requires a DRO to comply with the following additional requirements:

- have policies and procedures reasonably designed to identify and manage any conflicts of interest that arise in connection with the issuance of credit ratings,
- not issue or maintain a credit rating in the face of specified conflicts of interest,
- appoint a compliance officer (CCO) to be responsible for monitoring and assessing the designated rating organization's compliance with its code of conduct and the proposed regulatory framework,
- have policies and procedures reasonably designed to prevent the inappropriate use and/or dissemination of certain material non-public information, including a pending undisclosed rating action, and
- file on an annual basis a form containing prescribed information.

The DRO's CCO would be required to report to a board of directors or equivalent regarding circumstances of non-compliance with the DRO's IOSCO based Code and that non-compliance could create in the opinion of a reasonable person, a risk of harm to investors, to the capital markets and/or is part of a pattern of non-compliance.

DBRS agrees that the IOSCO Code is an appropriate central tenet for Canada's regulatory framework for CROs.

At its heart, the IOSCO Code is a framework of practical measures designed to improve investor protection and the fairness, efficiency and transparency of the securities markets and to reduce systemic risk. As cited above, among other areas, the IOSCO Code requires CROs to maintain high standards regarding conflicts of interests, the use of confidential information, public disclosure of ratings information and accuracy of ratings performance, and compliance. DBRS believes that the IOSCO Code, first published in December 2004 and strengthened in May 2008 in response to the global financial crisis, continues to provide a harmonizing platform for regulation of CROs around the world. Many CROs fashion their codes of conduct after the IOSCO Code, providing ease of comparability between CROs. Over 12O securities commissions and regulatory bodies around the world are members of IOSCO. Canada through its various provincial securities commissions is a member.

DBRS maintains a global Business Code of Conduct (Business Code) on its public website, www.dbrs.com that reflects its compliance with the IOSCO Code. DBRS has voluntarily adhered to the IOSCO Code since its initial publication in 2004. This Business Code, which is reviewed annually at a minimum, is a summary of the extensive range of policies, procedures and internal controls (collectively referred to as policies) that DBRS has implemented to ensure the objectivity and integrity of its ratings and transparency of its operations. DBRS has also established policies and practices that meet the SEC NRSRO requirements and the EU CRA Regulation. The DBRS Business Code is supplemented by an Employee Code of Conduct (Employee Code) which sets out, and provides guidance regarding DBRS standards of conduct to be followed by all DBRS staff.

Over the past several years, DBRS has focused on ratings transparency and disclosure, and on investor education efforts regarding what ratings mean and the role of CRAs. On its public website www.dbrs.com, DBRS publishes a wide range of information that includes among other documents, its rating philosophy, rating scales and definitions, rating policies, processes and methodologies, and monthly surveillance reporting so investors, regulators and other market participants can understand the basis for a DBRS rating.

To ensure investors are able to denote the type of rating being published, DBRS differentiates its structured finance (SF) ratings from traditional corporate bond ratings through the use of a SF modifier in all of its press releases and rating reports and on its public website. DBRS has implemented this SF modifier on a global basis.

In addition to the requirement for an IOSCO based code, the Proposed Instrument sets out in Annex C, Part 4 a number of other requirements that focus on conflicts of interest, material non-public information, compliance and governance.

DBRS takes analytical independence in the ratings process very seriously. DBRS has spent considerable effort to strengthen its policies and practices to identify, manage and prevent potential conflicts of interest that might arise in connection with the issuance of ratings. DBRS does not issue or maintain ratings where a conflict of interest would exist. DBRS also maintains a confidential information framework that prevents the inappropriate use and dissemination of material non-public information including with respect to a pending undisclosed rating.

As part of its governance framework, DBRS employs a global CCO who is responsible for oversight of DBRS compliance to its Business Code, staff compliance to the Employee Code and for overall compliance in all jurisdictions that DBRS does business. The proposed reporting of non-compliance to a Board of Directors by the CCO with respect to the risk of harm to investors and/or where there is a pattern of non-compliance is appropriate. However, DBRS suggests that having the CCO consider the risk of harm of non-compliance on the capital markets is overly broad and beyond the typical scope of a CCO.

In short, DBRS suggests that the Proposed Instrument reflects an “IOSCO comply or explain Plus” approach (IOSCO Plus) that provides a solid starting point for regulatory oversight of CROs in Canada.

However, ratings are international, and they are used internationally for a variety of reasons. DBRS’ ratings on Canadian banks and Canadian Covered Bond issues, for example, are important to European investors and Canadian issuers. Where ratings produced outside the European Union (EU) are used in the EU for regulatory capital purposes (referred to as endorsed ratings), CROs are required to comply with requirements “as stringent as” the EU CRA Regulation. As DBRS understands it, the term “as stringent as” does not mean “exactly the same as”.

DBRS’ highest priority is to issue high quality and consistent ratings. This can only be done from the jurisdiction where the appropriate analytical ratings expertise and experience is based. This means that on occasion DBRS will issue endorsed ratings into the EU where its Canadian expertise cannot simply be replicated or exported.

To facilitate global ratings usage, the proposed IOSCO Plus approach would need to be augmented for EU regulatory equivalence by June 7, 2011 in accordance with the endorsed

ratings requirements stipulated in the EU CRA Regulation[10]. DBRS believes Canada is in a strong leadership position to achieve international consistency while ensuring its CRO regulatory framework reflects the unique Canadian market. DBRS would welcome the opportunity to discuss possible options to enhance the Proposed Instrument.

Form 25-101F1 (Form) - Designated Rating Organization Application and Annual Filing

The Proposed Instrument requires a CRO wishing to be designated to file a completed Form or file its most recent Form NRSRO. It also requires the annual filing of information using the Form 90 days after the most recently completed year-end or if applicable, the DRO may file Form NRSRO information in line with SEC reporting dates.

The CSA indicate that they have developed the Proposed Instrument to ensure the obligations and responsibilities imposed on DROs are, to the extent feasible, complimentary to those in other jurisdictions.

DBRS appreciates the CSA's acknowledgement that certain CROs such as DBRS are global, and are registered with the SEC as an NRSRO. DBRS appreciates the CSA's efforts to align the application and filing requirements with the NRSRO approach, and believes this is a cost effective approach that drives consistency of requirements.

The annual NRSRO requirements are divided between public Form NRSRO disclosures and confidential reports filed only with the SEC. The dates for these filings are different: public disclosure information is required 90 days after the calendar year-end (i.e. March 31 annually), and confidential reports which include financial information are due 90 days after the NRSRO's financial year-end. The CSA's proposal aligns with these dates and regulatory obligations.

However, with respect to disclosure of amendments to the IOSCO based Code, DBRS suggests that the CSA change the requirement from three days of the amendment coming into effect to ten business days. For a CRO that is also a NRSRO, this change would result in consistency with the SEC's requirement for public disclosure of material changes to Form NRSRO and exhibits which include the NRSRO's code of ethics.[11]

Under Procedures and Methodologies, the Form requests information on "whether and, if so, how information about verification performed on assets underlying or referenced by a security issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings."

As outlined in its Business Code, DBRS has adopted reasonable measures so that the information it uses in assigning a rating is of sufficient quality to support a credible rating. These measures include a review of asset data, legal documents and client information. However, DBRS does not audit the information it receives in connection with the ratings process, and it does not and cannot independently verify information it receives in every instance. The extent of any factual investigation or independent verification depends on the facts and circumstances. A standard requirement for verification of information would fundamentally change the role of a CRO and

[10] Article 41 of the EU CRA Regulation states that points (f), (g) and (h) of Article 4(3) shall apply from 7 June 2011.
[11] DBRS' Business Code is DBRS' Code of Ethics for Form NRSRO. See Exhibit 5 under Form NRSRO found under Regulatory Affairs on www.dbrs.com.

the nature of ratings. DBRS plans to introduce disclosure in its reports that would describe the adequacy of information used in arriving at its ratings.

Proposed Legislative Amendments

DBRS notes that each of the provinces and territories either have or will be making legislative amendments to fully implement the proposed regulatory regime and provide each of the applicable securities commissions/regulators with the powers to enforce the regulations. Changes to local securities legislation may provide the following powers, among others:

- the power to conduct compliance reviews of a CRO and require the CRO to provide the securities regulatory authority with access to relevant books, information and documents, and
- the power to make an order that a CRO submit to a review of its practices and procedures, where such an order is considered to be in the public interest.

DBRS believes that the proposed powers including compliance reviews, access to books and records and reviews of practices and procedures are appropriate measures to ensure DROs are complying with the requirements of the Canadian regulatory framework.

Similar to the passport application process, DBRS would want to ensure that there is intra-provincial collaboration regarding ongoing supervision, compliance and other reviews and that the principal regulator plays the prime or leading role in this regard. In addition, to the extent that a DRO is also a NRSRO or NRSRO affiliate which is now subject to annual examination, DBRS suggests there should be some form of cross-border collaboration regarding compliance reviews.

DBRS acknowledges that Canadian securities regulatory authorities will build in legislative amendments that confirm they may not direct or regulate the content of credit ratings or the methodologies used to determine credit ratings. This approach is consistent with the scope of CRO regulation in other jurisdictions.

Consequential amendments – Issuer disclosure of ratings information

The CSA proposal also addresses ratings information disclosure.

The proposed consequential amendments to National Instrument 41-101 General Prospectus Requirements (Annex E), to National Instrument 44 -101 Short Form Prospectus Requirements (Annex F) and to National Instrument NI 51-102 Continuous Disclosure Obligations (Annex G) require issuers to publicly disclose certain ratings information. On the whole, DBRS believes such disclosure would assist market participants to better understand the nature of the ratings.

Disclosures for each of Annex E, F and G include:

(a) each rating received from a credit rating organization;
(b) for each rating disclosed under paragraph (a), the name of the credit rating organization that has assigned the rating;
(c) a definition or description of the category in which each credit rating organization rated the securities and the relative rank of each rating within the organization's overall classification system;
(d) an explanation of what the rating addresses and what attributes, if any, of the securities are not addressed by the rating;

(e) any factors or considerations identified by the credit rating organization as giving rise to unusual risks associated with the securities;
(f) a statement that a credit rating or a stability rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the credit rating organization; and
(g) any announcement made by, or any proposed announcement known to the issuer that is to be made by, a credit rating organization to the effect that the organization is reviewing or intends to revise or withdraw a rating previously assigned and required to be disclosed under this section.

The proposed disclosures are generally consistent with information that DBRS makes available or discloses at present.

However, Annex E, F and G also propose to require the issuer to disclose fee payments it makes to the DRO as follows: If payments were, or reasonably will be, made to a credit rating organization that provided a rating described in section (1), state that fact and separately disclose the amounts paid to the credit rating organization with respect to: (a) the rating, and (b) any other service provided to you by the credit rating organization during the last two years.

The CSA's proposed fee disclosure inappropriately raises an analytical independence conflict. The IOSCO Code as well as the SEC NRSRO rules and the EU CRA Regulation require CROs to separate their analytical personnel from all aspects of commercial fee activity to ensure the analytical independence and integrity of its ratings. DBRS has implemented policies to prevent its analysts from knowing fees paid to issuers. Such disclosure would allow DBRS analysts to become aware of these fees, and as such, DBRS suggests that this aspect of issuer disclosure be removed.

Annex B – Specific Requests for Comment

The CSA has requested comments on the following specific issues:

1. Section 7 of the Proposed Instrument provides that a Code of Conduct must specify that waivers of the Code are prohibited. The purpose of this provision is to ensure that the Code of Conduct reflects actual conduct within the designated rating organization. Do you think this provision is feasible? Does it achieve its purpose?

DBRS believes that a DRO's published Code of Conduct should reflect its actual practices and conduct. As such, DBRS does not think prohibiting waivers of the DRO's Code is unreasonable.

2. Item 3 of Form 25-101F1 requires a CRO (other than an NRSRO) applying to be designated under the Proposed Instrument to provide a completed personal information form (or PIF) for each director and executive officer of the applicant, as well as the compliance officer, unless previously provided. Do you believe the costs of requiring a PIF outweigh the benefits of these background checks? Should background checks be periodically requested for all existing designated rating organizations? If so, how often?

DBRS acknowledges that CROs who are NRSROs are exempt from filing PIFs. However, as a general comment, DBRS queries what a regulator would do with the PIF information. Where a CRO has non-Canadian officers and directors, there may be privacy and legal issues surrounding the requirement for a PIF. With respect to the proposed alternate of conducting periodic background checks, these are not always possible to carry out due to privacy legislation and

employment/labor legislation. In addition, what can be obtained legally is continually changing. Based on the small pool of CRO applicants, the number of executives would likely be known by the CSA such that the costs of a PIF approach would outweigh the benefits.

3. The test for determining the principal regulator for a CRO's designation application is set out in amendments to Multilateral Instrument 11-102 *Passport System*. Where a CRO does not have a head office or branch office located in Canada, the principal regulator is determined on the basis of "significant connection". Factors for determining "significant connection" are listed in section 8 of Proposed NP 11-205. Are the factors in section 8 suitable and listed in the appropriate order of influential weight?

Proposed 11-205 provides a CRO with the ability to use the "passport" regime to facilitate the process for designation in multiple jurisdictions. DBRS appreciates the CSA's collaborative approach to intra-provincial review and approval of a CRO's application.

DBRS agrees with the concept of a "significant connection" test to determine the principal regulator and that the following factors in order of influential weight are relevant: (a) jurisdiction where the filer generated the majority of its credit rating related revenue in the 3-year period preceding the date of its application, or (b) jurisdiction where the filer issued the most initial ratings in the 3-year period preceding the date of its application.

Another factor for the CSA to consider for the purposes of the principle regulator determination is the jurisdiction in which the CRO is registered as a business in Canada.

4. Currently, securities legislation does not require a CRO whose rating is referred to in a prospectus or other disclosure document to file an "expert's consent" with securities regulators, which would result in the assumption of statutory liability for its opinion. See, for example, section 10.1 of National Instrument 41-101 *General Prospectus Requirements*. Do you think that such an exemption is still appropriate in Canada?

DBRS believes that exemption from a CRO having to file an "expert's consent" where its ratings are referred to in a prospectus or other disclosure document is still appropriate in Canada. What occurred pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) with repeal of Rule 436(g) under the U.S. Securities Act of 1933 (Securities Act) is very instructive. The U.S. public market essentially froze until July 22, 2010 when the SEC issued a temporary no-action letter[12] allowing issuers for a period of 6 months to omit credit ratings from registration statements filed under Regulation AB.

As background, under Rule 436(g), which applied to U.S. public offerings registered under the Securities Act, NRSRO credit ratings were not deemed to be part of a registration statement prepared or certified by an "expert." As such, an NRSRO's consent was not required prior to including that entity's credit ratings in a registration statement. With the repeal of this rule, NRSRO consent to the inclusion of credit ratings in registration statements now must be obtained, and consenting NRSROs will potentially be exposed to "expert" liability.

[12] SEC Division of Corporate Finance issued a no-action letter to Ford Motor Credit Company that provided relief to the ABS Market. See http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm

DBRS[13] and other NRSROs have indicated that they will not consent to such inclusion because credit ratings are opinions about the likelihood that a debt will be repaid in the future. That is, ratings are forward looking and not historical statements of fact.

In the context of public cross-border securities offerings, particularly offerings conducted under the Canadian-U.S. Multijurisdictional Disclosure System ("MJDS"), DBRS is mindful that the U.S. versus Canadian treatment of expert consent may create a legal tension in offering the securities in both jurisdictions.

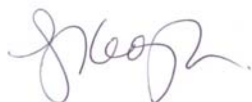
It remains to be seen how the SEC and U.S. Congress will deal with this issue after the expiration of the no-action letter on January 24, 2011.

Conclusion

DBRS appreciates the opportunity to comment on the Proposed Materials.

We would be happy to supply the CSA with additional information regarding any of the matters discussed herein. We would welcome the opportunity to provide input into options to enhance the Proposed National Instrument to address Canadian regulatory equivalency with other international markets. Please direct any questions about these comments to the undersigned.

Very truly yours,



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[13] Refer to press release DBRS Comments on U.S. Financial Reform Legislation dated July 20, 2010.
http://www.dbrs.com/research/234064/dbrs-comments-on-u-s-financial-reform-legislation.html