



FSCA COMMUNICATION 29 OF 2020 (CRA)

Publication of FSCA CRA Notice 3 OF 2020: Exemption of certain regulated persons from section 4 of the Credit Rating Services Act, 2012

1. PURPOSE

The purpose of this Communication is to inform stakeholders that the Financial Sector Conduct Authority ("Authority") has published, in terms of section 281(4) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) ("FSR Act"), FSCA CRA Notice 3 of 2020, exempting certain regulated persons from section 4 of the Credit Rating Services Act, 2012 (Act No. 24 of 2012) ("Credit Rating Services Act").

2. BACKGROUND

Banks Act

2.1 Section 85A(1) of the Banks Act provides:

"Notwithstanding anything to the contrary in any law, no bank or controlling company shall, in the calculation of its prescribed minimum amount of required capital and reserve funds, take into account a credit assessment of an external credit assessment institution or export credit agency unless the relevant external credit assessment institution or export credit agency obtained the prior written approval of the Registrar to act as an eligible institution."

2.2 Section 85A was introduced in 2007 by the Banks Amendment Act 20 of 2007 to give effect to the latest international standards governing capital adequacy, published as the Revised Framework on International Convergence of Capital Measurement and Capital Standards, better known as "Basel II".

2.3 An 'external credit assessment', is defined in section 1 of the Banks Act as:

'[A]n assessment or a rating issued by an eligible institution, which assessment or rating –

- (a) relates to the ongoing ability of a person or a country to repay amounts due and payable by the said person or the said country, including any principal amount and related interest; and*
- (b) meets the requirements as may be prescribed.'*

2.4 The former Registrar of Banks, in terms of regulation 51 of the Regulations relating to Banks, had approved the following credit rating agencies as eligible external credit

assessment institutions in terms of section 85A of the Banks Act:

- (a) Fitch Ratings;
- (b) Moody's Investors Service;
- (c) S&P Global Ratings; and
- (d) Global Credit Ratings Co.

- 2.5 The process for an approval of an eligible external credit assessment institution is set out in Regulation 51 of the Regulations relating to Banks. The Prudential Authority, which replaced the Registrar of Banks on 1 April 2018, may not grant its approval unless the eligible external credit assessment institutions comply with the requirements specified in Regulation 51(2).
- 2.6 Banks rely on the credit assessments from rating agencies that were approved as eligible external credit assessment institutions in terms Regulation 51 of the Regulations relating to Banks for purposes of the calculation of their prescribed minimum amount of required capital and reserve funds.
- 2.7 Banks may choose between two methodologies in order to calculate their capital requirements: the standardised approach or the internal ratings-based approach. In terms of the standardised approach, the banks rely on the credit rating assigned by an eligible credit assessment institution in respect of a particular type of counterparty (e.g. corporate or sovereign) and apply a specified risk weight to such counterparty for purposes of determining the amount of capital it must hold, given the credit risk of the particular counterparty.
- 2.8 The banks on the standardised approach rely, to varying degrees, on the ratings issued by approved eligible credit assessment institution for different types of exposures or counterparties, in accordance with the bank's specific internal policy on credit ratings.
- 2.9 In practical terms, the banks rely on the ratings that are publicly available on the websites of the eligible credit assessment institutions, regardless of where the eligible credit assessment institution is located or whether the eligible credit assessment institution is subject to a particular regulatory regime.

Credit Ratings Services Act

- 2.10 Section 4(1) of the Credit Rating Services Act provides:

"Where a regulated person uses published credit ratings for regulatory purposes, such a regulated person must only use credit ratings that are-

- (a) issued or endorsed by credit rating agencies which are registered in accordance with this Act; or*
- (b) issued or endorsed by an external credit rating agency approved by the [Authority]."*

- 2.11 "Regulatory purposes" is defined in section 1 of the CRS Act as:

“[T]he use of credit ratings for the specific purpose of complying with national legislation or the listings requirements made by an exchange under section 11 of the Financial Markets Act, 2012 (Act No. 19 of 2012)”

- 2.12 Where a bank meets the definition of a 'regulated person' in the Credit Rating Services Act, and it relies on the credit ratings, inter alia, to comply with national legislation (including the Banks Act and the Regulations relating to Banks) (i.e. for a 'regulatory purpose'), and the bank would, in terms of section 4(1) of the Credit Rating Services Act, be obliged only to use credit ratings issued or endorsed by a registered credit rating agency or an approved external credit rating agency.

3. APPLICATION FOR EXEMPTION

- 3.1 The banks rely on credit assessments from rating agencies that are approved as eligible external credit assessment institutions by the Prudential Authority in terms of the Banks Act, but not registered or approved in terms of the Credit Rating Services Act.
- 3.2 The approval as an eligible external credit assessment institution granted to a credit rating agency in terms of the Banks Act is given to the parent company of the credit rating agency, regardless of where it is located, and not to the specific branch or office registered in South Africa.
- 3.3 The Prudential Authority's approach in this regard has been informed by the fact that banks have exposures to institutions domiciled outside of South Africa, which must be rated by credit rating agencies that are recognised, registered or licensed in foreign jurisdictions and that the rating agencies use the same rating methodology across the different jurisdictions.
- 3.4 As a result, banks have acted in compliance with the Banks Act (by using credit assessments issued by eligible external credit assessment institutions) but not the Credit Rating Services Act because the ratings relied on by these banks are not issued or endorsed by credit rating agencies that are registered or approved by the Authority under the Credit Rating Services Act.
- 3.5 The Prudential Authority has applied to the Authority for an exemption in terms of section 27(1) of the Credit Rating Services Act which would allow banks as regulated persons that rely on the credit assessments from an eligible external credit assessment institutions for purposes of complying with the Banks Act, to be exempted from the provisions of section 4(1) of the Credit Rating Services Act.
- 3.6 On 24 October 2018, as a result of the above exemption application from the Prudential Authority, the Authority published a draft exemption notice to this effect, for public comment. Responses to the comments received are reflected in the document titled *“Response to public comments received on the draft proposed Exemption of Certain Regulated Persons from Section 4 of the Credit Rating Services Act, 2012”* published alongside of the exemption notice.

4. CONSIDERATION OF EXEMPTION CRITERIA

4.1 After considering the comments received on the draft exemption, the Authority is satisfied that the granting of the exemption under section 27(1) of the Act complies with the criteria set out in paragraphs (a) and (b) of that section and section 281(1) of the Financial Sector Regulation Act.

4.2 The following considerations were taken into account:

- (a) The eligible external credit assessment institutions are registered and supervised by regulatory authorities in foreign jurisdictions.
- (b) The exemption is aimed at enabling banks to rely on the credit assessments from eligible external credit assessment institutions for purposes of calculating their prescribed minimum amount of required capital and reserve funds in terms of the Banks Act.
- (c) The request is for the exemption to be of a limited duration until the necessary legislative amendments have been made.
- (d) A temporary exemption will not prejudice the interests of-
 - (i) the clients of registered credit rating agencies;
 - (ii) the users of credit ratings or credit rating services; or
 - (iii) regulatory authorities that rely on, refer to or use credit ratings in their supervision and regulation activities.
- (e) At this point in time for the reasons set out in paragraphs 2 and 3, practicalities impede the strict application of section 4(1) of the Act as contemplated in section 27(1)(a).

4.3 As a result, the Authority published a final exemption notice exempting banks together with the FSCA's responses to the public comments received on the draft exemption.

4.4 The exemption is intended to only apply for a limited period, pending the finalisation of necessary legislative amendments that will be made to both the Banks Act as well as the Credit Rating Services Act.

5. ENQUIRIES

For further information regarding this Communication and the contents of the exemption notice please contact the FSCA by emailing Roslynne van Wyk at roslynne.vanwyk@fsca.co.za.

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