



Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

SEC MEMORANDUM CIRCULAR NO. 7
Series of 2014

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

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 practices¹ 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.

¹ These are essential best practices as provided in **Asian Development Bank's Handbook on International Best Practices in Credit Rating**. It was released by ADB in December 2008. It aims to enhance rating practices and pave the way toward regional rationalization of ratings. It likewise aims to help investors (domestic and global) better understand credit ratings by domestic credit rating agencies and enable them to compare risks of different issuers. As indicated in the said Handbook, it considered among others, the International Organization of Securities Commission's *Statement of Principles Regarding the Activities of Credit Rating Agencies*, i.e., principles on quality and integrity of rating process, independence and conflicts of interest, transparency and timeliness of rating disclosure, and confidential information.

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 CRA's 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 pre-specified grace period (if any) shall constitute default.** A CRA shall adopt a consistent and uniform default definition. Such definition of default shall be rigorous and transparent to make a CRA's ratings more meaningful and accurate. It shall be clearly articulated and strictly applied.

Considering that CRAs accredited by the Commission cater primarily to bond market investors, a missed payment on a debt obligation on a due date or after a pre-specified grace period (if any) shall constitute default. The filing of bankruptcy before any missed payment on debt obligations, and involuntary rescheduling of debt obligations that is harmful to investor interest (such as lower coupon, extension of maturity, and interest waiver), shall also be considered a default.

A CRA shall adhere to its disclosed definition of default without exception, ensuring easier recognition of default. Such a definition shall not include any subjective grace period, and the resulting default statistics shall therefore not be influenced by any subjective factors and may be used by investors as an important input for credit pricing and provisioning requirements.

In case a CRA adopts a default definition that is divergent from the above requirement, such a divergence shall be disclosed and highlighted in all CRA communications relating to default. The CRA shall also provide the rationale for adopting a particular default definition; ensuring that investors are clear about the ideology behind the rating.

Irrespective of whether a CRA adopts an expected loss or probability of default approach for the assessment of credit quality, it shall adhere strictly to its objective default definition and ensure that default statistics are computed and published based on this definition.

C. Policies and Processes for Ratings

- (i) The CRA's operations manual shall have robust rating policies and methodologies and shall be consistently applied across ratings.**

The credit rating process shall detail the various steps and activities involved in assigning a credit rating, starting from the signing of the rating agreement, to the assignment of the rating and subsequent actions such as rating dissemination and surveillance. Every CRA shall have an operations manual that provides step-by-step guidelines for rating analysts to conduct rating assignments and that formalizes the rating process. Each step in the process shall also adhere to a strict timeline. Since lack of cooperation from the issuer can delay assignment execution, barring such exceptions, all CRAs shall adopt well-defined timelines for completion of each rating assignment.

A CRA shall strictly adhere to timelines not only for new ratings, but also for subsequent rating actions. However, a CRA shall not compromise analytical quality to arrive at quick rating decisions. A CRA shall publicize the approximate timeline of the rating process to set market expectations. It shall ensure transparent dissemination of information about rating policies and methodologies. It shall endeavor to increase awareness by users about its rating process, policies, and methodologies.

- (ii) **A CRA shall have well-defined and updated credit rating criteria, which are uniformly applicable across companies.** Every CRA shall refine its criteria and benchmarks proactively, taking into account changes in the market environment. Robust criteria assist in accurate assessment of credit risk for an entity. Ratings are subjective credit opinions based on various qualitative and quantitative factors; the robustness of ratings can be preserved only through consistent application of updated rating criteria.

Besides developing criteria for in-house use, CRAs shall publicize a broad criteria framework. They shall ensure consistent application of criteria for easier comparison of ratings and meaningful default and transition statistics.

- (iii) **A CRA shall have a well-planned training program for all its employees.** A CRA shall target each year a minimum number of training days for all employees and centrally monitor them to ensure programs are fully implemented. CRAs shall ensure training programs are given high priority at all times. To ensure adequate funding, a CRA shall allocate a separate budget for training programs, monitoring it strictly for any underuse.
- (iv) **For interactive ratings, the rating process shall include a detailed meeting with the management of the issuer to gain a better perspective of the rated entity.** Open dialogue between a CRA and an issuer shall be made to gain deeper insight into the issuer's governance, policies, and corporate strategy. It shall help the analyst to understand factors such as financial and business plans and management policies, which can have a critical bearing on the rating. It shall likewise provide a forum for analysts to arrive at a qualitative assessment of management competence.

Although the issues discussed in a management meeting can vary, key issues shall be listed for such management meetings to gain maximum advantage.

Insights that can emerge from management meetings for rating assignments in manufacturing and services sector include:

- the status and prospects of the issuer's industry;
- the issuer's financial policies and objectives, the reasoning behind them, and its plans for achieving them;
- a broad overview of the issuer's major business segments, and comparisons with competitors; and
- an issuer's capital expenditure plans and alternative financing options, both in its own right and as a means of assessing the management's risk appetite.

Although a CRA shall not be influenced by the financial projections of the issuer or the issuer's view of its prospects, these projections shall be considered as valuable tool in the rating process because they serve as a fair indicator of:

- management plans;
- management's assessment of possible challenges; and
- its planned solutions to deal with such problems.

- (v) **Policy relating to active dependence on third parties.** While executing rating assignments, analysts often rely on third-party certifications, such as the auditor's report on annual accounts, along with reports and representations from bankers, solicitors, valuers, actuaries, and other professionals. Each CRA shall adopt a uniform and consistent policy on the degree of reliance it will place on such third-party information and certification. This aspect shall be disclosed in the rating rationale to highlight the role clarity plays between a CRA and such third parties.
- (vi) **Rating analysts shall be competent to perform their tasks.** A CRA's rating analysts shall have the necessary skills to perform their tasks and should be well-versed in risk assessment methods. A CRA shall not employ any analyst with a tainted reputation as it can impact credibility. It shall disclose the name of the analyst in its rating rationale, along with a declaration of any interests (such as shareholding) that the analyst may have in the rated entity.
- (vii) **Formal rating committees shall decide ratings.** The existence of the rating committee as the final decision-making body shall be considered by a CRA as one of most important safeguards for the independence of rating decisions. All rating decisions shall be made by a duly constituted committee(s). The rating committee must comprise of members who have the professional competence to assess credits and have no interest in the entities being rated. The Chairman and Senior Members of the committee shall have extensive experience in relevant areas in the domestic financial markets; global exposure will also help. The other

members of the committee are expected to have sufficient background on said areas.

The rating committee may also include outside experts provided they fully adhere to a CRA's code of ethical conduct and sign a confidentiality agreement.

The name and personal credentials of the permanent rating committee members shall be published on the CRA's website.

The rating committee shall be responsible in taking final decision on assignment of ratings to ensure objectivity. Such decision shall be the result of a collective thinking of a group of experts analyzing the risks pertaining to the particular entity. Analysts shall prepare a written credit analysis report for the deliberation of the rating committee. A credit rating shall be valid for a period decided by the rating committee. The proceedings of the rating committee shall be minuted and maintained for future reference.

Although voting rights in rating committee decisions shall be limited only to members of the committee and the analytical team, discussions during the committee shall be open to all CRA analytical personnel to ensure knowledge and committee insights are widely disseminated within the organization and rating decisions are transparent. To keep the rating independent of any issuer influence, members with business development responsibilities shall not have voting rights in the rating committee.

To avoid any bias from rating committee members and enhance rating committee integrity and credibility, the rating decision shall be based on voting by a minimum of three members.

- (viii) **A credit rating announcement shall be accompanied by a report giving the principal reasons for the rating.** A credit rating shall be an informed opinion resulting from in-depth analysis of various credit rating factors. The opinion shall take into account information obtained from the issuer, secondary sources and CRA in-house experts, which should be assessed within clearly spelled out rating criteria. Each rating has to be accompanied by a rating report that details the above.

A credit rating report shall discuss the basis of a CRA's rating decision. With every rating action accompanied by such a report, it shall also reflect the quality and consistency of analysis. The report shall highlight the key factors affecting the rating and provide forward-looking opinions on these factors. Because such a report is the only public document available to the investor, it shall represent the highest standards of quality in content, accuracy, and timeliness.

Each CRA shall create and maintain a website for investors, issuers, and other stakeholders, and make credit rating reports available there, either free of charge or at a nominal fee. A credit rating and

the rating report shall be current and updated to reflect credit quality at any given point of time.

- (ix) **The rating committee's decisions shall be subject to a clearly described review or appeal process.** In the event that the issuer disagrees with the initial rating, and has additional information that it believes can make a material difference to its rating, the issuer shall have recourse to an appeal process. A CRA shall clearly articulate this process in public and include it in the written rating agreement between the rated entity and the CRA.

Upon receiving valid information, the rating committee shall discuss the merits of the case and may or may not decide to modify the rating. Each CRA shall have a clearly-articulated and well-defined appeal process because appeals may bring about new or fresh perspectives with bearing on the rating. This shall ensure that rating committee decisions are robust, accurate, and fair. While an appeal process is critical for the initial rating, a CRA shall ensure that such an appeal process is not misused by the issuer to delay a rating action in the case of rating reviews, especially rating downgrades.

The committee that decides the appeal shall have at least one member who did not participate in the original rating to bring in a fresh perspective.

- (x) **All rating actions shall be announced promptly, and a list of outstanding ratings made freely available on a CRA's website.** After the issuer accepts the rating, its dissemination shall not be delayed. Acceptance from the issuer may be needed when the rating is assigned the first time; but no further acceptance is needed for subsequent rating actions. A CRA shall formulate a time-to-release procedure to be followed after the initial rating acceptance. Similarly, a time-to-release procedure has to be put in place for revisions of ratings that are already public.

There shall be strict timelines for communicating the rating to the issuer, receiving acceptance, and preparing the media release and release of the rating. This assumes particular significance when bond markets become more liquid and rating information may affect trading prices. A 5-day time frame shall be adopted for the entire cycle. A CRA shall have a well-defined internal policy for public dissemination of rating information.

When ratings are changed, delay by the issuer in responding shall not hinder a CRA from publicizing the revised rating.

- (xi) **Every rating shall be kept under surveillance until it is withdrawn.** A credit rating on an instrument must reflect credit quality throughout the period when the rating is outstanding. It is a CRA's responsibility to ensure this objective is met. To this end, after the initial rating has been assigned, the issuer's performance and economic environment must be constantly monitored by the CRA.

Steps in the rating surveillance process shall include:

- communicating with the entity at regular intervals to understand developments and trends in performance to help analysts compare company performance against their own and the company's expectations, as well as against peers;
- checking the status of issues that may affect the entity's credit quality (such as an initial public offering), exploring the probability of such issues arising in the near future, and assessing the management's perspective on such issues;
- discussing financial performance with the entity on the declaration of interim financial results; and
- understanding strategic plans or new initiatives that could have rating implications.

Surveillance shall also enable analysts to stay abreast of current developments, to discuss potential problem areas, be apprised of any changes in the issuer's plans, and to distinguish between realistic and over-optimistic management expectations.

- (xii) **A CRA shall conduct formal reviews involving meetings with issuers.** A CRA shall adopt a formal policy of conducting continuous and periodic reviews. It shall keep all rated credits under continuous surveillance until withdrawal of ratings. However, a CRA can also choose to conduct periodic surveillance. Such a policy shall ensure that every rated credit is tracked at least annually and the rating on such a credit continues to reflect the inherent credit quality.

For such a review to be effective, it shall include meetings with the management. Such review meetings shall focus on critical developments over the period since the last meeting and the outlook for the coming year. In between such annual reviews, a CRA shall also assess an entity's interim financial performance.

The broad outline of these reviews could involve:

- tracing the effects of various developments in the business;
- addressing any concerns on governance; and
- analyzing the impact of any change in management policy or stance.

In addition, immediate rating reviews shall be undertaken whenever any event or development takes place (such as an acquisition or merger) that may affect the credit quality of the rated entity or instrument. Such immediate reviews may be mostly event-driven and be performed as the need arises.

Possible causes for such a review include:

- significant changes in top management;
- significant corporate action such as merger, acquisition, equity offering, or buyback;
- significant differences between actual and projected performance;
- new developments in the industry; and
- changes in applicable criteria.

At times, the issuer may not provide sufficient information for surveillance. If so, the CRA, wherever possible, shall conduct surveillance on a best-effort basis and all rating communications shall prominently disclose this fact. But if a CRA feels constrained in its rating view, even on a best-effort basis, it can suspend the rating until such time that the issuer furnishes information. This suspension shall be made public.

The requirement of ensuring periodic surveillance until the rating withdrawal and the publication of surveillance reports signals to the market that the rating is current and accurate, and can be relied upon for investment decisions.

- (xiii) **If a rating is assigned to a related entity, this shall be adequately disclosed in all rating communication.** If a rating is assigned to an entity in which any member of a CRA's board or senior management has a direct or indirect interest or involvement, such a person shall be excluded from voting on the rating, even if he or she is part of the rating committee. The relevant details about the involvement shall also be adequately disclosed in every rating communication. This is to avoid any possible influences or biases and to signal that the rating has been arrived at through an unbiased process.
- (xiv) **Maintenance of records.** A CRA shall maintain all records pertaining to a rating exercise for a reasonable period of time, or as warranted by regulations. Such records have to be maintained for all ratings, including unaccepted ones. Maintenance of records of the rating assignments and the related working papers shall be visible proof that the CRA exercised abundant caution and requisite due diligence.
- (xv) **Rating disclaimers.** A CRA shall provide sufficient explanation to users of ratings that these are forward-looking assessments and provide a broad sense of an issuer's expected performance, and therefore, shall not be used as an absolute indicator. A CRA must make the users aware that ratings are not the last word on a company's track record or its future performance. A CRA shall accompany its ratings with sufficient description of the meaning and limitations of ratings. Such descriptions, by way of disclaimers, shall specifically refer to what factors ratings do not address and the proper perspective for looking at ratings.
- (xvi) **A CRA shall have separate functional groups, each having specific responsibilities in the rating process.** Separate functional

groups shall be formed within a CRA to ensure that the execution and follow-through of the rating assignment is smooth and efficient. The following groups shall be established:

Business development group. Responsible for obtaining mandates from prospective entities, this group shall handle all business communication and finalize the commercial terms of the rating assignment. A CRA's business development group shall be separated from its analytical group.

Analytical group. This group handles all analytical responsibilities for a rating assignment and for assessing credit risk for the relevant entity. It shall not be involved in any commercial discussions with the entity. This group shall be responsible for the rating process from receipt of written consent for a rating until the time the rating is made public. It shall also be responsible for surveillance and review of ratings.

Rating administration. The existence of a separate functional group for the administration of the rating process will ensure it is followed, and that timelines are strictly respected. This group shall look after the progress of a rating assignment from the initiation stage until the dissemination of the final rating to the public. This group shall also maintain a list of all outstanding ratings and proper documentation to support credit opinions, and shall handle external dissemination of ratings and rating reports.

Criteria group. This group shall be responsible for formulating, maintaining, and refining the criteria framework under which the various types of issuance will be rated. This group will ensure, before implementation that any new criteria proposed are thoroughly discussed from both an analytical and market impact perspective.

These functional groups, although separate, shall be collectively responsible for the successful implementation of the rating process. They shall help a CRA build up a substantial base of information on its ratings, present a transparent approach to the financial markets, and help the CRA if it is subjected to regulatory inspection.

If the setting up of functional groups is not practicable due to the size and structure of the CRA, sufficient alternative procedures shall be established to ensure that the execution and follow-through of the rating assignment is smooth and efficient. These procedures shall be clearly provided in the CRA's manual of operation.

D. Confidentiality Requirements

- (i) All information submitted by a related entity or an issuer in connection with a credit rating assignment shall be presumed**

confidential and shall be kept so at all times. The information provided by the company may be highly sensitive and confidential and may be provided by the issuer to a CRA only for the purpose of arriving at the ratings. Every CRA must maintain such information in strict confidence and cannot use it for any purpose other than rating. When the assigned rating is made public, the CRA shall ensure that the rating report accompanying the rating and the other information about the entity present in the report shall not breach this confidentiality. Contact with bankers, auditors, and others --if made as part of rating process--- shall be with the ratee's consent.

Every CRA must have a confidentiality policy to ensure that the confidential information shared by the issuer is not disclosed outside of the ratings business. The fact that an issuer has sought a rating is in itself confidential information, and is to be made public only when an accepted initial rating is released. In case the initial rating is not accepted, the assignment shall remain confidential and shall be disclosed only to the Commission. However, in all such cases, the ratee shall be informed in advance about the disclosure.

- (ii) **The confidentiality requirement must be binding on all company officers and employees who have or may have access to such confidential information, and acknowledged in writing.** Confidentiality of information is of paramount importance to a CRA, and relevant measures and processes must be in place in the organizational structure to maintain confidentiality of such information at all points in time. All employees who may have access to such confidential information must, without exception, acknowledge compliance with the code of confidentiality in writing. Such an affirmation by way of self-certification shall be obtained from the employees on a periodic basis as a legally binding undertaking, and shall be enforced even after termination of employment or association with the CRA.
- (iii) **Members of the board of directors shall not have access to confidential information submitted by the rated entity unless a director is a member of the rating committee.** To ensure that confidentiality is not breached, there shall be a policy in a CRA that even members of the CRA board of directors will not have privileged access to a ratee's confidential information, unless they are part of the rating committee.
- (iv) **Confidentiality of information is a contractual obligation and shall be formally documented in the agreement to perform credit rating services.** Confidentiality of information shall be part of the contractual obligations of a CRA and documented in rating agreements.

E. Independence and Avoidance of Conflicts of Interest

To manage conflicts of interest and communicate proactively to the market, a CRA must have a clearly articulated policy and a public stance on the conflicts of interest that it may face and the efforts that the management will take to control them. This policy shall cover the following:

- (i) A CRA shall not refrain from taking a rating action because of the potential effect of the action on the CRA, an issuer, an investor, or other market participant.
- (ii) The determination of a credit rating shall be influenced only by factors relevant to the credit assessment.
- (iii) A CRA shall adopt a definition of what constitutes a conflict of interest, publish it, and all company officers and employees shall avoid such conflicts. Clarity on conflicts of interest will help ensure rating decisions are without bias and personal influence.
- (iv) CRA disclosures of actual and potential conflicts of interest shall be complete, clear, and prominent.
- (v) Rules for avoiding conflicts of interest shall be applied to all employees who participate directly or indirectly in the credit rating process, particularly to analyst and rating committee members. The board of directors, upon election, shall affirm its adherence to the CRAs' code of conduct.
- (vi) Any potential conflicts of interest from any member of the rating team must be declared before participating in a credit rating engagement. Where a conflict of interest exists as defined by company policy and rules, the employee concerned shall refrain from participating in the rating assignment and rating committee proceedings.
- (vii) In order to maintain analysts' neutrality and to prevent employees from making gain through misuse of confidential information, a CRA shall adopt a trading and investment declaration policy. This could categorize possible investment avenues into classes: acceptable, acceptable with prior permission, and unacceptable. The securities that fall into each of these categories shall be based on an articulated policy that is well disseminated within the organization.
- (viii) Ratings assigned by a CRA to an issuer or issue shall not be affected by the existence of, or potential for, a business relationship between the CRA and the issuer (or its affiliates) or any other party, or the absence of such a relationship.
- (ix) In instances where rated entities (for example, governments) have, or are simultaneously pursuing oversight functions related to a CRA, the CRA shall deploy different employees (than those

involved in oversight issues) to conduct its rating exercise.

- (x) No CRA employee shall participate in or otherwise influence the determination of a rating of any particular entity or obligation if the employee:
 - o has had recent employment or another significant business relationship with the rated entity that may cause or be perceived as causing a conflict of interest;
 - o has an immediate relation (such as a spouse, partner, parent, child, or sibling) currently working for the rated entity; or
 - o has or had, any other relationship with the rated entity or any related entity thereof that may cause or may be perceived as causing a conflict of interest.
- (xi) All CRA employees shall be prohibited from soliciting money, gifts, or favors from anyone with whom the CRA does business and shall be prohibited from accepting gifts in cash or gifts exceeding minimal monetary value as specified by the CRA.
- (xii) A CRA shall periodically and publicly disclose its ownership pattern, including the details of promoters and other shareholders along with the extent of their shareholding. A CRA shall also clearly and unequivocally disclose affiliations and technical partnerships it has with any international rating agency.
- (xiii) A CRA analyst, who becomes involved in a personal relationship, creating the potential for real or apparent conflict of interest, shall be required to disclose that relationship to the appropriate manager or officer of the CRA, as determined by CRA compliance policies.
- (xiv) CRA employees shall take all reasonable measures to protect all property and records belonging to or in possession of the CRA from fraud, theft, or misuse.
- (xv) A CRA or its employees shall not selectively disclose non-public information about its rating opinions or possible future rating actions, except to the issuer or its designated agents.
- (xvi) CRA employees shall not share confidential information entrusted to the CRA with employees of affiliated entities.
- (xvii) A CRA shall ensure that compensation for analytical personnel is not linked to revenues earned from the ratings that are executed by the analyst's concerned. This will nurture a neutral analytical atmosphere which revenues earned on the assignment will not influence ratings.
- (xviii) A CRA shall disclose whether any issuer, originator, arranger, subscriber, or other client and its affiliates make up more than 10% of total CRA revenue.

- (xix) Each CRA shall adopt a formal policy of disclosure when it rates securities issued by its promoter. The policy in such cases shall ensure that adequate disclosure of the shareholding is made in all rating communications so that the market is aware of the potential conflict of interest.
- (xx) A CRA shall establish policies and procedures for reviewing the past work of analysts that leave the employ of the CRA and join an issuer.
- (xxi) A CRA shall periodically review analyst remuneration policies to ensure they do not compromise the objectivity of the rating process.
- (xxii) A CRA shall define what is considered ancillary business and reasons for the same.

F. Policies for Private, Unsolicited, and Unaccepted Ratings

- (i) **Private ratings.** A CRA may be requested, either by issuers or by third parties, to assign private ratings. In such cases, the CRA shall not publicly disclose the ratings. To formalize this, and to ensure that the facility is not misused, a CRA shall adopt a specific policy of complete confidentiality in such cases. The policy shall clearly articulate the non-publication and non-dissemination of the private rating. At the same time, because the rating is private, no specific public debt may be raised using the private rating because the CRA will not be able to disclose any subsequent change in credit quality through public release.
- (ii) **Unsolicited ratings.** Unsolicited ratings are those that the rated entity does not consent to or participate in. Wherever a CRA assigns unsolicited ratings, it shall distinguish them—using some sort of notation—from interactive ratings. A clear distinguishing prefix or suffix (such as "pi" to denote public information rating) will help the user make an informed judgment about using the rating.

A CRA that assigns unsolicited ratings that are not directly revenue generating shall have adequate justification for doing so. More specifically, a CRA shall not resort to conservative unsolicited ratings as a way of coercing issuers to obtain higher interactive ratings for which they will need to pay. A minimum of 2 years between initiating coverage through an unsolicited rating and the first interactive rating of the same issuer shall be observed.

- (iii) **Unaccepted ratings.** Initially, in an interactive rating, the issuer will normally be given the choice of accepting or not accepting the rating. In such cases, it is prohibited to disclose the rating without obtaining written consent. But once the rating is accepted for the first time, a CRA shall not seek acceptance before publicizing changes in the rating.

A CRA shall have a published policy regarding the non-disclosure of unaccepted ratings. Where the rating is interactive and the rated entity has not accepted the initially assigned rating, the information pertaining to the entity shall be held in the strictest confidence and shall not be disclosed in CRA rating lists. Such unaccepted ratings may only be shared with regulators or a court of law, upon specific request to provide such information.

G. General Code of Conduct

- (i) **A CRA shall adopt its own code of ethical conduct applicable to all employees and board members.** A CRA shall adopt a code of conduct, drafted and modified as per CRA requirements and scope of operations. This code, with assurance of rigorous compliance, shall be published on the CRA's website.
- (ii) **A CRA shall formally adopt the International Organization of Securities Commission Code of Conduct and the prescribed code of conduct.** To the extent that current legislation, policy, regulatory arrangements, or prevalent market practices may impede adherence to these principles, a CRA shall strive to make appropriate changes. There is often no single correct approach to such changes, and they shall reflect local market conditions and historical development. Wherever these principles cannot be adopted *in verbatim* due to specific market conditions or existing practices, a CRA shall highlight the extent of non-adoption along with specific reasons for such deviation.
- (iii) **The chief executive officer or president and all other employees of the company will be required to affirm in writing their compliance with the company's code of ethical conduct.** An affirmation must be obtained from all employees, legally binding them to the company's code of ethical conduct. All CRA employees must ensure strict adherence.

CRA's shall also undertake outreach initiatives such as discussion forums for investors, conference calls after major rating actions to provide additional clarity to investors, periodic publication of criteria, frequently asked questions, analytical opinion pieces, and research articles. These measures can enhance CRA credibility among investors, issuers, and regulators.

H. Compliance with Policies and Processes

- (i) **Process audit.** Each CRA shall set up rigorous audit checkpoints to ensure adopted best practices, policies, and procedures are carried out. Such checkpoints must be manned by independent professionals with extensive knowledge and experience in credit ratings. Such an audit group must be headed by a senior professional who reports directly to the chief rating officer or to an equivalent position.

The audit group shall provide feedback to operating groups such that any corrective action can be taken on a periodic basis.

If the setting up of an internal audit group is not practicable due to the size and structure of the CRA, sufficient alternative mechanism shall be established to determine whether adopted best practices, policies, and procedures are carried out. These procedures shall be clearly provided in the CRA's manual of operation.

- (ii) **Compliance officer.** A CRA must have an officer to ensure compliance with all code of conduct provisions. The compliance officer shall report to the CRA board or chief executive officer or president. This officer shall continuously monitor for violations of the code by any employee and be expected to prepare and submit regular status reports on compliance with CRA regulations and the code of ethical conduct.
- (iii) **Whistleblower policy.** A CRA must have detailed whistleblower policies encouraging all employees to report (with complete confidentiality) any unethical practice or grave misconduct to a designated authority. All reported events shall be taken seriously and investigated promptly. The investigation report shall be submitted within a stipulated time frame (as specified by the CRA) from the receipt of the complaint. There shall be provisions to prevent discrimination, retaliation, or harassment against any whistle-blower or participant in the investigation process.

I. **Conducting Outreach**

A CRA shall publish articulate reports on matters of industry-wide importance with the broad objective of educating and enhancing the depth of the markets in which it operates. Ratings consistency studies, financial comparative studies such as median analysis, and other data-mining studies can be pursued and possibly made into regular featured publications.

5. **Reportorial Obligations**

- A. A copy of the Credit Rating Report (CRR) shall be furnished to the Commission through the Office of the General Accountant, simultaneous to its submission to the issuer-ratee. A CRR shall be in two (2) formats, notice form and long-form report.
 - (i) The **notice form of CRR** shall be used for public announcement of the rating and it shall indicate the highlight of the factors considered for the rating.
 - (ii) The **long-form CRR** shall provide a discussion of all the basis underlying the factors considered including the source documents

relied upon. It shall likewise contain the information prescribed under paragraph 4 of these Guidelines.

- (iii) Both forms shall be signed by an authorized officer of the CRA who shall likewise indicate his consent on the use of such report for evaluation and documentation as part of the registration statement of the issuer-ratee.
- B. In addition to the annual financial statements and general information sheet, a credit rating agency accredited by the Commission must submit the following documents within ninety (90) days from the end of its fiscal year:
 - (i) A report on the rating activities conducted during the most recently completed fiscal year. It shall include the name of the ratee, issue, ratings given, and other relevant information;
 - (ii) A duly accomplished scorecard indicating its compliance with each of the best practices required under paragraph 4 of these Guidelines.
- c. In relation to the requirements under par. (4)(C)(xii) of these Guidelines, a change in credit rating as a result of a review by the CRA or a failure to access information from the issuer shall trigger the mandatory submission to the Commission by the CRA of a report disclosing the matter within five (5) business days from the date of change or from the date of denial by the issuer to provide sufficient information.

6. Penalties

Failure to comply with any of the foregoing requirement shall be a sufficient ground, after due notice and hearing, for the suspension or revocation of the accreditation of the credit rating agency and/or for the imposition of a monetary fine under the Consolidated Scale of Fines and Penalties of the Commission.

7. Transitory Clause

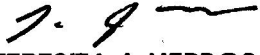
- A. All CRAs that are accredited as of effectivity of these Guidelines shall submit, within thirty (30) days from effectivity of these Guidelines, a Manual of Operation containing the procedures prescribed hereof with a covering Board of Directors' resolution adopting the said Manual.
- B. For its initial year of implementation, the reportorial requirements under paragraph 5(B) of these Guidelines shall be complied with not later than April 30, 2014.

8. Effectivity Clause

This Circular shall be effective fifteen (15) days after the date of its last publication in two (2) newspapers of general circulation in the Philippines.

Signed this 6th day of March 2014, Mandaluyong City, Philippines.

For the Commission:


TERESITA J. HERBOSA
Chairperson