

Annex A

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

Kroll application

Kroll has filed an application for designation as a DRO. The OSC is the principal regulator for the Kroll application.

Kroll's application is significant and novel since it is the first designation application from a credit rating organization whose credit ratings have:

- not previously been referred to in CSA rules and policies, and
- not generally been used in the Canadian marketplace.

Kroll mainly operates in the United States, where it is registered as a “nationally recognized statistical rating organization” with the United States Securities and Exchange Commission.

Regulatory approach to Kroll application

Under applicable securities legislation, the OSC can only make a designation for the purpose of allowing an applicant credit rating organization (a **DRO Applicant**) to satisfy:

- a requirement in securities law that a credit rating be given by a DRO, or
- a condition for an exemption under securities law that a credit rating be given by a DRO, (collectively, **Credit Rating Provisions**).

The Credit Rating Provisions serve a “minimum standards” function by establishing minimum levels of credit quality of securities for certain regulatory purposes (e.g., the availability of an exemption or an alternative process in a rule). The Credit Rating Provisions currently refer to specific credit ratings of the four existing DROs. It is therefore appropriate for the principal regulator to consider whether a DRO Applicant's credit ratings can satisfy this minimum standards function for specific Credit Rating Provisions.

This requires the principal regulator to consider the following as part of its designation decision:

- whether the DRO Applicant has sufficient experience and expertise in rating the particular types of securities and issuers covered by specific Credit Rating Provisions; and
- the appropriate credit rating level for the specific Credit Rating Provisions.

As a result, the principal regulator should only make its final designation order in conjunction with appropriate rule and policy amendments being made to the relevant Credit Rating Provisions.

Analysis of Kroll application

Based on the information provided by Kroll, it appears that Kroll has sufficient expertise and experience in rating ABS for purposes of the ABS Short Form Eligibility Criteria. Consequently, subject to confirmation and completion of certain matters, staff anticipate recommending that Kroll be designated as a DRO, but only:

- for the purposes of the ABS Short Form Eligibility Criteria, and
- following Ministerial approval of the Amendments.

At this time, staff do not anticipate recommending that Kroll be designated as a DRO for purposes of other Credit Rating Provisions.

Appropriate rating categories of Kroll for ABS Short Form Eligibility Criteria

Based on the information provided by Kroll, it appears that a Kroll long term credit rating of “BBB” and a Kroll short term credit rating of “K3” are the appropriate rating categories for purposes of the ABS Short Form Eligibility Criteria.

- Under the ABS Short Form Eligibility Criteria, an ABS issuer must have a “designated rating” from a DRO, which would include a long term credit rating at or above “BBB” (for DBRS, Fitch and S&P) or “Baa” (for Moody’s).
- As part of its work in determining the appropriate rating categories of Kroll, staff compared a large number of credit ratings of Kroll for numerous ABS issuers in the United States against those of DBRS, Fitch, S&P and Moody’s for the same issuers. This work allowed staff to consider whether Kroll regularly gave higher or lower credit ratings than its competitors.

Staff considered the experience of Kroll in rating ABS issuers in the United States to be relevant in determining the appropriate rating categories of Kroll for purposes of the ABS Short Form Eligibility Criteria.