



Securities and Exchange Commission of Pakistan
Securities Market Division

Before The Director / HOD (LCID)

In the matter of Show Cause Notice issued to JCR-VIS Credit Rating Company Limited
under Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

October 22, 2015

Present at the Hearing:

Representing JCR-VIS Credit Rating Company Limited

- | | | |
|-------|---------------------|-------------------------------|
| (i) | Mr Faheem Ahmed | CEO-JCR-VIS |
| (ii) | Ms. Faryal Faheem | Executive Director-JCR-VIS |
| (iii) | Khawaja Naveed Amin | Director-Business Development |

Assisting the Director/HOD (LCID)

- | | | |
|------|------------------|-----------------|
| (i) | Muhammad Arshad | Joint Director |
| (ii) | Ms Nazish Zubair | Deputy Director |

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. SMD/CR/JCR/2/2015 dated October 16, 2015, ("**SCN**") served on JCR-VIS Credit Rating Company Limited ("**Respondent**"), a Credit Rating Agency (CRA) registered by the Securities and Exchange Commission of Pakistan ("**Commission**") under Rule 5 of the Credit Rating Companies Rules, 1995 ("**Rules**").

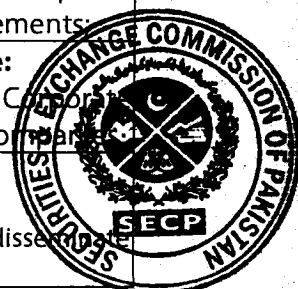
2. Brief facts of the case are that the Commission conducted onsite inspection of the respondent in exercise of its powers conferred by Section 29(2) of the Securities and Exchange Commission of Pakistan Act, 1997 read with Rule 7 of the Rules. The inspection revealed that the Respondent was, *prima facie*, noncompliant with the following clauses of the Code of Conduct for Credit Rating Companies/Agencies ("**CRC Code**") issued under Rule 7 of the Rules:





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#	Clause	Requirement
1	Clause 2.1(a)	develop well-defined rating criteria, methodologies and procedures for solicited and unsolicited credit ratings, each class of entity, instrument and issue and such rating criteria, methodologies and procedures will act as guiding principles for analysts to enable them to analyze and interpret the information appropriately. The criteria, methodologies and procedures shall be updated proactively, taking into account changes in the market environment;
2	Clause 2.1(d)(i)	Quality of the rating process: CRA shall (d) keep the following records in support of each credit rating and review thereof: (i) summary of discussions with the issuer, its management, auditors and creditors which have a bearing on the credit rating;
3	Clause 2.1(d)(ii)	Quality of the rating process: CRA shall (d) keep the following records in support of each credit rating and review thereof: (ii) decisions of the rating committee, including voting details and notes of dissent, if any, by any member of the rating committee;
4	Clause 2.2(a)	monitor all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer;
5	Clause 2.3.1(a)(ii)(D)	Appointment of the Compliance Officer: (a) CRA shall (ii) ensure that compliance officer shall be responsible for: (D) redressal of creditors', investors' and other stakeholders grievances and complaints; and
6	Clause 3.4(a)	A CRA shall have adequate infrastructure and information systems to provide reliable rating services and maintain its credit rating operations and facilities with adequate security, system capacity and contingency arrangements;
7	Clause 3.6	Adoption of the Code of Corporate Governance: CRAs are encouraged to adopt the Code of Corporate Governance issued by the Commission for listed companies;
8	Clause 4.1(c)	RESPONSIBILITIES: Transparency and Timeliness: A CRA should conduct industry specific studies and disseminate findings of such studies on its website.





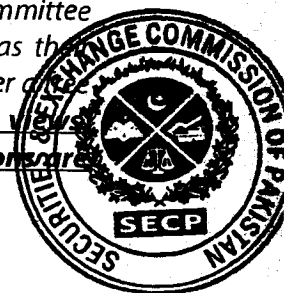
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9	Clause 4.3.2.2	List of Fee/Charges: A CRA shall prepare list of charges relating to rating services and disseminate the same on its website. The list of charges must contain all the rating services render and functions perform by it and the rate of fee for each such service and function. The fee may be provided in terms of percentage, in the form of range (i.e. minimum and maximum) or in the form of fixed amount for each service/function.
10	Clause 4.6(a)	A CRA shall have analysts who are competent and qualified to carry out rating assignments and subsequent monitoring of the ratings. In assessing the competence of its analysts, a CRA shall consider, among other things, their level of education; experience within the sector, industry and geographic location; experience with particular transactions and asset classes; and other areas of expertise;

3. In light of the inspection findings, the Commission served a SCN on the Respondent under section 22 of the Securities and Exchange Ordinance, 1969 ("Ordinance"). Hearing in the matter of aforesaid SCN was scheduled for November 04, 2015 at the Commission Head Office, NIC Building, Islamabad.

4. The Respondent submitted its reply on October 30, 2015 and appeared for hearing on November 04, 2015. The arguments put forth by the Respondent during the course of hearing are summarized as below:

- (i) *JCR-VIS has always endeavored to keep itself abreast with changing market conditions. All rating methodologies are regularly reviewed by JCR-VIS and as and when necessitated, updated methodologies are published. We envisage to update all our existing methodologies pertaining to which ratings are outstanding by the end of June 2016.*
- (ii) *In line with practices at other rating agencies, JCR-VIS primarily engages with the key management of the ratee during the rating process. Notes of all such discussions are taken by the analysts which are later **fully incorporated in our draft rating reports which are then presented to the rating committee**. However, from now onwards, all analysts are required to maintain these notes/minutes of the meetings separately and store them in hard copies as well as scanned copies. Minutes of all rating committee meetings are maintained and signatures of all participants are considered as their respective votes. The RC is central to the ratings process and is designed to foster an exchange of views among participants **with full consideration of dissenting views**. RC composition is based on expertise and diversity of opinion and its **decisions are based on a consensus** with all members having equal voting rights.*

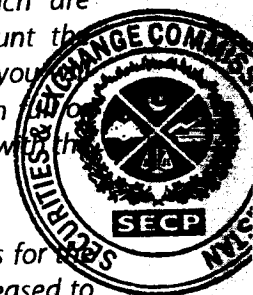


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- (iii) We believe that this approach where all members agree to a rating is superior and closer to the spirit of Clause 1.7 of IOSCO's CRA Code of Conduct as ultimately, the **rating committee as a whole stands by the rating decisions** that are taken and we cannot encourage the practice where individuals may try to absolve themselves of their responsibility towards the rating decisions taken by recording dissenting votes (on either side i.e. on the lower side or the higher) which may reflect unnecessary conservativeness or liberal views.
- (iv) All clients are assigned to one of multiple rating teams at JCR-VIS, whose primary responsibility is to ensure continuous surveillance of outstanding ratings; this includes one mandatory annual review where a rating action (could result in rating change or may be a reaffirmation of outstanding rating) is necessarily taken in addition to which, any change in risk profile of the issuer/issue is also regularly tracked by the rating team. The latter entails review of periodic financial statements, any news item pertaining to the company specifically or the sector in large in which the company operates
- (v) Email addresses of each employee including the Compliance Officer are publicly available on our official website through which external stakeholders can contact the Company. Additionally, each public announcement contains the names and telephone numbers of the persons to be contacted. However, a page for feedback & complaints for external stakeholders is developed and is made public on the Home page of our official website. Weblink of the same is also provided here: <http://jcrvis.com.pk/FeedbackComplaints.aspx>
- (vi) The disaster recovery plan is in place and all our data, information, reports and other soft files are backed regularly on mass storage devices on a daily basis. All back-ups are handled only at the server level managed by our network administrator with no back-up responsibility on any analyst. A set of these mass storage back-up devices, having storage capacities in terabytes, are also placed off-location on a rotational basis. In order to enhance our back up redundancy, the Company is also planning to maintain an off-site parallel server which would be mirroring our production server on real time basis. We are in the phase of evaluating the financial and operational requirement of the parallel server which is expected to be up and running before the end of this financial year.
- (vii) JCR-VIS is not a listed company; however, we may consider adoption of CCG once we have a rating/revenue critical mass. Even the **Code of Conduct for CRAs 'encourages' and does not 'require' this compliance**. Moreover, our policies and procedures are also governed by Codes of Conduct issued by IOSCO and ACRAA, which are comprehensive in nature and are specifically designed to take into account the nuances of rating agencies; JCR-VIS has adopted these voluntarily. However, you appreciate the fact that most of the operations of our Company are either in partial compliance with the CCG; we also envisage enhancing this compliance with the passage of time.
- (viii) JCR-VIS is already in the process of updating or developing new sector studies for the sectors in which the Company is conducting ratings. However, you will be pleased to



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note that all our rating reports (updated on regular basis) contain a comprehensive overview on the respective sector/industry in which the rated entity is operating

- (ix) Our license is issued to promote and develop Capital Markets in Pakistan. Sometimes we accommodate smaller entities and encourage them to get themselves rated or get a rating on a new product so that investors could be better informed. You will appreciate the fact that in order to promote rating culture in the country and to support the rated entity, JCR-VIS has conducted a few ratings against very nominal fees ranging as low as Rs. 500/-.
- (x) Currently, JCR-VIS rating team consists of 18 analysts in total with 6 senior level analysts. List of all employees is also available on our website. Details of working experience of each member of the analytical team are also attached for further clarity. You would appreciate that our work environment requires a very high degree of professional skill and a sound understanding of the business dynamics which we have to maintain given the limited market segment for ratings. The breadth and intensity of the work exposure of the analysts generally very soon places them at an edge in the job market, hence they leave the job for better opportunities

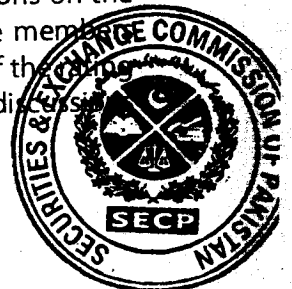
5. I have examined the inspection findings, and views of the Respondent to the show cause notice, as well as departmental representatives on the date of hearing. The Respondent has agreed with the following observations of the inspection team:

- (i) Clause 2.1 (a)
- (ii) Clause 2.1 (d)(i)
- (iii) Clause 2.3.1 (A) (ii) (D)
- (iv) Clause 3.6
- (v) Clause 4.1(c)
- (vi) Clause 4.3.2.2

The following observations of the inspection team were argued at length by the Respondent. The outcomes of the discussions are as under.

Clause 2.1(d)(ii)- Minutes of rating committee

A rating is based on an analytical decision of the rating committee. Being professionals, the members of rating committee are expected to provide objective and fair opinions on the rating to be assigned. Therefore, it is imperative that deliberations among the members are recorded in detail. This would ensure the independence and transparency of the process. After detailed deliberations, the Respondent agreed to record the discussions made in the rating committee in detail.



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Clause 2.2(a)-Monitoring and surveillance of outstanding rating

The inspection team observed that the Respondent did not conduct monitoring and surveillance of its outstanding ratings as required under clause 2.2(a) of the CRC Code. During the hearing the Respondent stated that they did monitor all their outstanding ratings and provided reports regarding monitoring and surveillance of the credit rating conducted by the Respondent. The reports were shared with the inspection team and they agreed with the Respondent point of view.

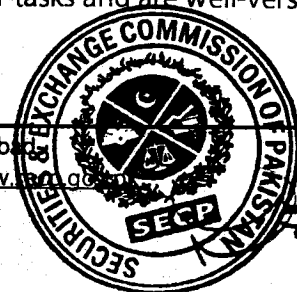
Clause 3.4(a)-Management Information System of the company

The Respondent was reliant on its parent company Vital Information Statistics for its management information system ("MIS"). During the course of inspection, the Respondent was unable to provide customized management information reports as required by the inspection team. During the hearing, the issue was discussed in detail. A company can outsource its MIS. However, the company should ensure that the MIS being provided is capable enough to cater to all the needs of the company, its management and other stakeholders. The reports requested by the inspection team were basic reports which any MIS should be capable enough to generate. Being a credit rating company, a well-developed MIS is of vital importance as it not only provides real time information for the top management but also caters to the queries from the regulators and other stakeholders. In view of the above, the Respondent should preferably develop its own MIS keeping in view its requirements. This would not only end its dependence on external parties to whom the function has been outsourced but would also enable the Respondent to tweak the MIS as per its requirement.

During the course of inspection, the analysts informed the inspection team that the backups were being taken on USB storage mass. During the hearing, the Respondent informed that the disaster recovery plan is in place and clarified that all its data, information, reports and other soft files are backed on mass storage devices, having storage capacities in terabytes, on a daily basis. All these back-ups are handled only at the server level managed by the network administrator. A set of these mass storage back-up devices are also placed off-location on a rotational basis. The Respondent further informed that it is also planning to maintain an off-site parallel server which would be mirroring its production server on real time basis. In view of the facts put forward by the Respondent which were also agreed by the inspection team, the issue regarding backing up of data stands closed.

Clause 4.6(a)-competency of rating analyst

Analysts play very important role in the rating process and their educational qualification coupled with their experience have an impact on the quality of ratings being assigned. It is therefore important that analysts have the skills to perform their tasks and are well-versed in risk assessment methods.





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I have reviewed the information provided by the Respondent and observed that majority of the rating analysts possessed an average experience of 1.5 years. This issue was discussed in detail and the Respondent admitted the fact that their analysts had little relevant expertise. The Respondent however, clarified that the ratings are not conducted by an analyst in isolation but by a group of rating analysts headed by a senior analyst. The Respondent further informed that the junior analysts are being supervised and guided by their senior colleagues on a continuous basis. I agree with the point of view of the Respondent but keeping in view the importance of the skill set, it is desirable to hire experienced human resource.

6. The onsite inspection was the first ever inspection of a credit rating company since its inception. The Respondent has tried to comply with various requirements of the CRC Code and provided evidence suggesting rectification of some of the violations noted during inspection. The Respondent has also shown its willingness to comply with the requirements of the CRC Code in letter and spirit in future. Hence, keeping in view the observations made by the inspection team and the comments submitted by the Respondent thereto, I am not imposing any monetary penalty on the Respondent. However, the Respondent is hereby strictly warned to ensure strict compliance of regulatory framework as any non-compliance in future would render the Respondent liable to monetary penalties stipulated under the law

7. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matter subsequently investigated or otherwise brought to the knowledge of the Commission.

Announced on January 19, 2016
Islamabad.




(Nasir Askar)
Director/HOD (LCID)