



Securities and Exchange Commission of Pakistan
Securities Market Division

Before The Director / HOD (LCID)

In the matter of Show Cause Notice issued to Pakistan Credit Rating Agency (Pvt)
(PACRA) Ltd under Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

October 22, 2015

Present at the Hearing:

Representing Pakistan Credit Rating Agency (Pvt) Limited

(i) Mr. Farrukh Jawad Panni

Assisting the Director/HOD (LCID)

- (i) Mr. Muhammad Farooq, Additional Director (LCID)
- (ii) Mr. Muhammad Arshad, Joint Director (LCID)
- (iii) Ms Nazish Zubair, Deputy Director (LCID)

ORDER

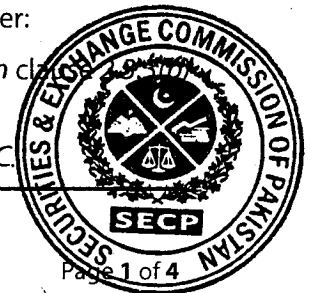
This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. SM/PACRA/1/2015 dated October 6, 2015, ("SCN") served to Pakistan Credit Rating Agency Limited ("**Respondent**") which is a credit rating company registered with the Securities and Exchange Commission of Pakistan ("**Commission**") under Rule 5 of the Credit Rating Companies Rules, 1995 ("**Rules**").

2. Brief facts of the case are that this office received a complaint dated August 28, 2015 from JCR-VIS Credit Rating Company ("**JCR**") wherein JCR informed that one of their clients, Faysal Asset Management Ltd (**FAML**), has switched over to the Respondent for their fund stability rating without obtaining NOC or giving notice to them in contravention of the Conduct for Credit Rating Agencies (the "**Code**"). The matter was referred to the Respondent for their comments. After analyzing the complaint in light of the comments received, the SCN was issued to the Respondent as to why penalty may not be imposed on them under section 22 of the Securities and Exchange Ordinance, 1969 ("**Ordinance**") for violating clause 2.3.3(b) of the Code.

3. The Respondent, through Barrister Panni & Associates (the "**Counsel**") submitted its reply to the SCN on October 16, 2015. The Counsel appeared for hearing on October 22, 2015. The arguments put forth by the Counsel during the hearing are as under:

- i. PACRA bonafidely believes that the term 'pre-mature termination' used in clause 2.3.3(b) of the Code applies only in case of time-bound ratings.
- ii. PACRA has never considered any switch-over to-date which required NOC.

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- iii. *Tendering of a second rating opinion during the subsistence of an existing rating, in relation to a perpetual rating, is a normal practice of the rating industry world-wide, where an already rated issuer approaches another rating agency for a new assessment of its credit worthiness*
- iv. *As per PACRA's interpretation of the Code, the Code doesn't bar dual perpetual ratings but it simply prohibits switch-overs/pre-mature termination of a time-bound/limited-life rating opinion*
- v. *Since the three FAML stability ratings, not involving limited life instrument ratings, were done during the currency of the JCR perpetual ratings on August 20, 2015 i.e. before the issuance of the FAML Termination Notice dated August 21, 2015 and as the deletion/withdrawal of JCR ratings is effective from September 29, 2015, PACRA ratings do not amount to Rating Shopping, therefore it is not hit by the provisions of clause 2.3.3 (b) or under any other express provision of the Code.*
- vi. *The preamble of the Code states -"for establishing a **procedural framework** for credit rating companies it is a universally accepted principle of law that any procedural lapse does not entail levy of penalty or otherwise allow knocking-down the respondent on technical ground.*
- vii. *Attention is invited to the provisions of section 22 of the Ordinance and particularly the use of words, "the Commission may', if it is satisfied' ... the failure was willful' by order direct" As levy of penalty is outcome of a criminal charge, it requires presence of 'mens rea' (guilty mind) followed by a 'willful' act of a free agent i.e. a contumacious, wanton, perverse and a stubborn act, done heedlessly without believing it to be lawful In this respect, please refer to a decision of the Supreme Court of Pakistan reported as **PLD 2005 SC 530**. As PACRA had issued the ratings in question believing it's action within the parameters of the Code, it could be safely deduced that there was no element of willful failure present in the case.*
- viii. *Without prejudice to PACRA's said stance it is submitted for your gracious consideration that the use of word 'may' in section 22 implies that levy of penalty is discretionary even after a subjective finding of guilt actuated by a willful failure.*
- ix. *At the end, the Respondent requested the Commission to take lenient view in the matter as the situation occurred due to misunderstanding.*

4. I have examined the response of the Respondent through the Counsel to the SCN and the verbal arguments of the Counsel on the date of hearing.

5. Admittedly, the Respondent has accepted rating assignment from FAML. The issue at hand is to determine whether the Respondent has followed the procedure prescribed in clause 2.3.3(b) of the Code or not. I am reproducing clause 2.3.3(b) for ease of reference:

Clause 2.3.3(b) "The CRA shall

(b) not accept a rating assignment where a client has previously terminated a rating contract with its existing CRA, unless such client obtains No Objection Certificate (NOC) from its existing CRA or ensure



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that it shall continue credit rating with its existing CRA till the period as agreed in the rating agreement. A clause to this effect shall be included by the CRA in each rating agreement; and

6. The plain reading of the Code and the Rules reveals that it does not prohibit multiple credit ratings of a single product or entity. However, the Commission has prescribed in clause 2.3.3(b) of the Code a procedure to be followed by a credit rating company in case of multiple ratings of a single product or entity or where a rating agreement has been prematurely terminated by a company. The referred clause puts two responsibilities on a credit rating company.

(i) **In case the company decides to obtain a second credit rating:** The credit rating company is required to obtain written confirmation from the company that it would continue its credit rating with the existing credit rating till the period mentioned in the rating agreement.

(ii) **In case a company prematurely terminates its credit rating agreement:** The credit rating company would not accept the rating assignment until and unless the company provides an NOC from its previous credit rating company.

7. The chronological events of the instant case are given in the table below:

Name of Fund	JCR				PACRA		
	Rating Agreement	Date Rating assigned	Rating	Rating withdrawal letter	Rating Agreement	Date of Rating Assigned	Rating assigned
FIGF	November 23, 2011 (valid till November 22, 2015)	June 29, 2015	A(f)	August 21, 2015	July 01, 2015	August 20, 2015	A(f)
FMMF	November 04, 2010 (valid till November 03, 2015)	June 29, 2015	AA(f)	August 21, 2015	July 01, 2015	August 20, 2015	AA+(f)
FSGF	January 01, 2011 (valid till December 31, 2015)	June 29, 2015	A(f)	August 21, 2015	July 01, 2015	August 20, 2015	AA-(f)

8. From the above chronology of events it is clear that FAML entered into rating agreement with the Respondent during the validity of its rating agreement with JCR i.e. immediately after announcement of rating of all the three funds of FAML by JCR. In terms of clause 2.3.3(b) of the Code, the Respondent was required to obtain a prior written confirmation from FAML that it would continue its rating with JCR till the period mentioned in the rating agreement. However, no such written confirmation was obtained by the Respondent from FAML in contravention of clause 2.3.3(b) of the Code. The Respondent announced the ratings of the funds of FAML on August 20, 2015 and FAML vide its letter dated August 21, 2015 informed JCR to withdraw its ratings for the funds under its management i.e. **prematurely terminated its rating agreement with JCR**.



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9. In the written reply and during the hearing, the Counsel took the plea that clause 2.3.3(b) was not applicable on the Respondent as the 'pre-mature termination' clause mentioned in clause 2.3.3(b) was applicable only in case of time-bound ratings and that the Code didn't bar dual perpetual ratings but it simply prohibited switch-over/pre-mature termination of a time-bound/limited-life rating. The Code is written in plain language and even a cursory reading of the Code would reveal that it does not make any differentiation between credit rating for limited life and perpetual life products/entities and therefore has not specified any separate procedures in case of switchover/ obtaining multiple rating for them. In view of the above, the Respondent should have followed the procedure laid down in clause 2.3.3(b) of the Code while accepting the rating assignment of funds of FAML.

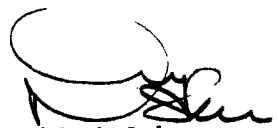
10. Based on the foregoing discussion and available record, I am of the considered view that the Respondent has violated clause 2.3.3(b) of the Code. Pursuant to clause 1.5 of the Code, all the credit rating companies are required to follow the Code, which has been issued by the Commission in exercise of the powers conferred by rule 7 of the Rules. The failure to comply with the requirements of the Code attracts penal provisions of section 22 of the Ordinance. With regard to it to being willful, it has been held by the Court of law that a default in the case of breach of duty will be considered 'willful' even if it arises out of being recklessly careless, even though there may not be knowledge or intent.

11. Therefore, in exercise of powers under Section 22 of the Ordinance; I hereby impose a penalty of Rs. 600,000 for the contravention of regulatory framework prescribed under the said section. The Respondent is directed to deposit the penalty amount in the account of Securities and Exchange Commission of Pakistan and furnish the deposit slip to this effect within thirty days of the receipt of the order.

12. 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)