

GAZETTE NOTICE NO. ...8512..

**THE CAPITAL MARKETS ACT
(Cap. 485A)**

**GUIDELINES ON THE APPROVAL AND REGISTRATION
OF CREDIT RATING AGENCIES**

IN EXERCISE of the powers conferred by section 12 of the Capital Markets Act, the Capital Markets Authority issues the Guidelines set out in the Schedule hereto, which shall have effect with regard to all applications to the Authority for the approval and registration of credit rating agencies.

SCHEDULE

1. Introduction

The Capital Markets Authority is seeking to promote the establishment of credit rating agencies as part of measures aimed at building an active corporate securities debt market and impetus to deepening of the domestic capital markets.

These are guidelines on the requirements for approval and registration of credit rating agencies in Kenya.

1.1 Credit Rating

Credit rating is an objective and independent opinion on the general creditworthiness of an issuer of a debt instrument, and its ability to meet its obligations in a timely manner over the life of the financial instrument based on relevant risk factors including the ability of the issuer to generate cash in the future. Ratings rank the debt issue within a consistent framework to compare risk among the different debt instruments in the market and assign a risk grade.

As it pertains to assessment of future likely positions on the basis of both quantitative and qualitative judgement and past performance, credit rating is necessarily subjective. The goal of the rating process is to arrive at a reasoned judgement on credit risk not through a set formula but rather through a careful review and analysis of the critical issues surrounding a specific debt and the issuer. This in particular includes the ability of the management to sustain in future, cash generation in the face of adverse changes in the business and economic environment. A rating is therefore an informed opinion of future outcome based on known qualitative and quantitative factors.

A rating does not constitute a recommendation to purchase, sell or hold a particular security. In addition, a rating does not comment on the suitability of an investment for a particular investor.

The objective of a credit rating is to provide independent, high quality, impartial, value-added quantitative and qualitative review as well as analytical information on the risk profile assessment of issuers of financial instruments.

It therefore serves to promote confidence in the capital markets and enhance transparency by facilitating investors' awareness on underlying risks of an issuer or issued financial investment through assignment of ratings.

2. Core Professional Capacity

- 2.1. The applicant must make evident its capacity to perform the role of a rating agency.
- 2.2. The applicant must have a background and experience as well as professional expertise to provide the service of a rating agency.
- 2.3. The applicant must either be in the process of appointing or have appointed professionals including economic, financial and research analysts, and other relevant quantitative and qualitative analysts who have the relevant background in the rating business.

3. Objectivity and independence

- 3.1 The applicant must demonstrate its independence and objectivity.
- 3.2 The applicant must not be associated directly or indirectly with group(s) who have conflicting interests in the area of the rating business.

- 3.3 The applicant must also demonstrate that it has a proven rating methodology.
 - 3.4 The rating process must have sufficient internal checks and balances to safeguard objectivity in particular where qualitative judgement also plays an important role in the rating process.
 - 3.5 The rating process must be based on quantitative and qualitative review of facts and must not rely on hearsay or rumours to downgrade or upgrade a particular issuer or issued financial instrument.
4. Ownership
- 4.1 In order to ensure independence and objectivity, the applicant must be a body corporate with a preponderance of an institutional shareholding of repute.
 - 4.2 The shareholders, board of directors, management and professional analytical staff should be persons of impeccable character.
 - 4.3 The applicant should partly be owned by an internationally recognized rating agency or have a contractual arrangement with an internationally recognized rating agency that provides technical and strategic support drawn from international experience.
 - 4.4 For purposes of this guideline, an internationally recognized agency shall be a rating agency which has been in the business of providing credit ratings for debt securities or any securities or any securities of interest to investors, which obligates the issuer to pay back the principal amount raised, in more than two markets for at least five years.
 - 4.5 The ownership structure or association and capital level shall not be the only basis or criteria of determining the independence and integrity of a rating agency.
5. Capital Requirements
- The applicant shall have a stable financial base with a minimum paid up capital of Kshs.12 million (or the equivalent).
6. Disclosure of information by rating agency
- The rating agency must disclose to the Authority, issuers and the general public the following:
- (i) General fee structure or any change thereof
 - (ii) Downgrades of ratings
 - (iii) Disclosure of ratings of commercial paper or corporate bonds as applicable.

7. Confidentiality

The rating agency must have a system of maintaining on a confidential basis the information supplied strictly for the purpose of rating by issuers in order to safeguard and promote confidence in the rating process.

8. Documents to accompany the application for approval and registration of a credit rating agency in Kenya

An application for approval and registration should be made to the Capital Markets Authority accompanied by the following:

- (i) Certificate of Incorporation, Memorandum and Articles of Association;
- (ii) Business plan (to include resumes of the top management staff, management structure, brief on the rating methodology, rating grades, fee structure);
- (iii) A sample of a standard agreement between the rating agency and its clients; and
- (iv) Draft sample “letter of requests” for rating accompanied by a draft of the “information requirements for rating securities”.

Dated the 21st November 2001.

DENIS D AFANDE
Chairman
Capital Markets Authority

PAUL K MELLY
Chief Executive
Capital Markets Authority