

Notice of the People's Bank of China, the National Development and Reform Commission, the Ministry of Finance, the China Banking and Insurance Regulatory Commission, and the China Securities Regulatory Commission on Promoting the Sound Development of the Credit Rating Industry for the Bond Market

To the People's Bank of China (PBC) Shanghai Head Office, all the branches and operations offices of the PBC, all the central sub-branches of the PBC in capital cities of provinces (autonomous regions) and in sub-provincial cities; all the development & reform commissions and finance departments (bureaus) of provinces, autonomous regions, municipalities directly under the Central Government, cities under separate state planning, and the Xinjiang Production and Construction Corps; all the local offices of the China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission:

In accordance with the *Law of the People's Republic of China on the People's Bank of China*, the *Company Law of the People's Republic of China*, the *Securities Law of the People's Republic of China*, the *Budget Law of the People's Republic of China*, the *Regulations on the Administration of Enterprise Bonds*, the *Interim Measures for the Administration of the Credit Rating Industry*, and other laws, regulations and administrative rules, the Notice is hereby issued to promote the well-regulated development of the credit rating industry for the bond market, improve the quality and competitiveness of credit ratings in China, and push the credit rating industry towards better serving the sound development of the bond market. The provisions are as follows.

I. Enhancing the development of a credit rating methodology system to improve ratings quality and differentiation

1. Credit rating agencies (CRAs) shall develop, over the long term, a rating quality verification mechanism with the default rate at its core and lay out implementation plans, so that they shall set up and put into practice, by the end of 2022, a credit rating methodology system that can achieve reasonable differentiation to effectively improve the quality of ratings. The rating methodology system shall be scientific, rational, objective, and comprehensive in combining quantitative and qualitative analysis. CRAs shall conduct annual tests on the rating methodology models and representative enterprises. They are encouraged to publish, on a regular basis and by rating grade, the lists of representative

enterprises together with their performance against the rating criteria, and disclose information about the annual tests.

2. Except for credit rating adjustments caused by normal business operations, such as mergers, acquisitions, and divisions, where an adjustment of three or more notches is made at a time to a rating, the CRA shall promptly launch a comprehensive backtesting examination to check and evaluate, among other things, the consistency, accuracy, and stability of the rating methodology models as well as the ratings, and publish the results and corresponding measures.
3. CRAs shall duly improve the effectiveness and foresightedness of their initial ratings and follow-up ratings, strengthen dynamic risk monitoring via multiple channels and methods, and keep pace with the changes in credit risk factors. Upon occurrence of any material event that impacts the solvency of a rated entity or its willingness to meet its debt obligations, CRAs shall launch, in a timely manner, ad hoc follow-up ratings and fully explain the reasons for adjustment or maintenance of the rating in the rating report.
4. CRAs shall rate an entity primarily based on the creditworthiness of the entity itself. In rating local government bonds, CRAs shall consider the characteristics of general bonds and special bonds while taking into account such factors as economic and social development under local circumstances and fiscal revenue and expenditure, in order to issue ratings objectively and fairly to properly reflect the differences between regions or projects.
5. CRAs shall keep up efforts on informatization. They shall set up databases and technology systems that can meet their needs of business development as well as regulatory requirements, and they shall increase the competitiveness of the credit rating industry through technological innovations and applications. In compliance with relevant laws and regulations and provided that risks are controllable, CRAs are encouraged to develop innovative rating technologies and use sci-tech means, such as big data and artificial intelligence, in credit risk analysis in order to improve the quality of rating data and their abilities to identify and monitor risks. CRAs are also encouraged to strengthen cooperation with credit reporting agencies.

II. Improving CRAs' corporate governance and internal controls to ensure rating independence

6. CRAs shall improve their corporate governance structure in strict compliance with the *Company Law of the People's Republic of China*. They are encouraged to bring in independent directors to guarantee effective supervision. The directors, supervisors, and senior executives of CRAs shall be loyal, honest, and diligent in performing their duties. CRAs shall improve the institutional arrangements for

the credit review committee and ensure its independence in order that rating decisions are fair, objective, and independent.

7. CRAs shall reinforce their firewalls. They shall improve and strictly implement the rules, such as on separation, avoidance, rotation of analysts, and accountability of former employees, and shall effectively identify, prevent, and eliminate conflicts of interest to ensure separation between rating and commercial functions and between rating and non-rating businesses. The assessment, promotion, and compensation of the rating personnel shall not be linked with such factors as issuance of what they have rated or the fees charged therefrom.
8. CRAs shall enhance their internal control and supervision mechanisms, strengthen management of the entire rating process and all of their personnel in terms of regulatory compliance, and strictly prohibit the acceptance or solicitation of bribes. The actual controllers, shareholders, credit review committee members, directors, supervisors, and senior executives of a CRA shall maintain the independence of the agency and its businesses. The compliance department shall fulfill its duties by supervising and reviewing the compliance of the CRA and its personnel, the adequacy of internal control rules as well as the effectiveness of implementation, reporting to the board of directors and other relevant mechanisms in a timely manner, and seeing that improvements are put in place.

III. Strengthening information disclosures and market constraints

9. CRAs shall make adequate disclosures, such as on rating methodologies, models, and results, as required by regulatory authorities. They shall disclose, on a quarterly basis, the distribution of ratings and the results of quality check, and ensure the truthfulness, accuracy, completeness, and timeliness of their disclosures. CRAs shall make separate disclosures on the creditworthiness of each one of the rated entities. Where external support is factored into the final rating result, CRAs shall enhance the analysis and disclosure of such factors, explicitly disclose the lift from the external support, and give detailed explanations to justify the support and show its effectiveness.
10. We shall take steps to promote fair competition in the credit rating industry. Issuers are encouraged to select two or more CRAs to provide ratings, while more work shall be done to expand the application of investor-paid ratings. Results of such ratings can be used as references in bond valuation and pricing, development of bond index products, bond-pledged repos, and other mechanisms as well as in internal control.

CRAs are encouraged to conduct proactive ratings and investor-paid ratings and disclose the rating results so as to enable cross-check verification between dual ratings, multiple ratings, or ratings via different models.

11. Self-regulatory organizations shall establish a market-based assessment and evaluation system that is investor-oriented and centers on the quality of ratings. They shall carry out market-based assessment and evaluation on a regular basis while placing more emphasis on the follow-up disclosure and application of results so as to give investors more say, effectively leverage the role of market reputation, and build upon the quality of ratings a merit-based selection system for the rating industry.

IV. Optimizing the ecosystem for ratings to create a level playing field

12. We shall lower the regulatory requirements for external ratings, make adjustments, when appropriate, to the regulatory policies setting thresholds for the grades of bonds that can be invested in, and reduce the dependence of bond-pledged repos on external ratings to let the market decide its demand for ratings. We shall stress the cultivation of qualified institutional investors. Investors should improve their risk controls such as the internal ratings system, heighten risk awareness, enhance their risk management capacity, and make rational use of credit rating results.
13. Issuers, credit enhancement agencies, and intermediaries shall cooperate with CRAs in rating operations such as due diligence. In compliance with relevant laws and regulations, they shall provide the needed material in a timely manner while refraining from interfering with rating decisions or the independence of credit rating operations. Where CRAs cannot carry on their rating operations independently, objectively, and fairly because issuers, credit enhancement agencies, or intermediaries refuse to cooperate, they shall duly suspend or terminate the rating process and let it be known to the public. CRAs shall conduct their businesses independently according to the law, free from interference by any entity or individual. While promoting their businesses, the actual controllers and major shareholders of CRAs shall not disrupt or impede fair competition in the rating industry.
14. We shall prudently advance the opening-up of the credit rating industry and support eligible overseas CRAs to enter China's bond market. We shall work on the cultivation of a number of Chinese CRAs with international influence and support their participation in international ratings based on their own choice and ability.

V. Tightening supervision and punishment

15. We shall strengthen the interconnection between regulatory agencies, joining efforts to gradually unify the bond market access requirements for CRAs and to set uniform standards for CRA businesses. We shall enhance regulatory coordination and information sharing regarding business inspections, admonitions and punishments, entry and exit, etc. to improve regulatory

effectiveness and prevent regulatory arbitrage. We shall organize CRAs to make good-faith commitments and publish important information on www.creditchina.gov.cn or through other channels to strengthen public supervision.

16. We shall step up inspections of CRAs in terms of their rating quality and regulatory compliance throughout the rating process. Of particular concern are circumstances where the ratings differentiation is markedly below the average level of the industry, follow-up ratings are slow to take place, dramatic adjustments are made to rating grades, or an upgrade comes with a change of CRAs. The CRAs and responsible persons that have committed irregular or illegal conduct, such as rating grade competition, trading of ratings, provision or acceptance of improper benefits, or deliberate interference with rating independence, shall be punished according to relevant regulations or be subject to criminal investigation by the judicial authorities in accordance with the law.

The Notice shall come into effect on August 6, 2022.